

TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

March 18, 1980

Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Staff Statements Appended to the Transcript

Mr. Pardee, Manager for Foreign Operations  
Mr. Sternlight, Manager for Domestic Operations  
Mr. Kichline, Associate Economist  
Mr. Axilrod, Economist

Meeting of Federal Open Market Committee

March 18, 1980

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, March 18, 1980, at 9:30 a.m.

PRESENT: Mr. Volcker, Chairman  
Mr. Guffey  
Mr. Morris  
Mr. Partee  
Mr. Rice  
Mr. Roos  
Mr. Schultz  
Mrs. Teeters  
Mr. Wallich  
Mr. Winn

Messrs. Baughman, Eastburn, Mayo, Timlen, and  
Willes, Alternate Members of the Federal  
Open Market Committee

Messrs. Balles and Black, Presidents of the  
Federal Reserve Banks of San Francisco  
and Richmond, respectively

Mr. Altmann, Secretary  
Mr. Bernard, Assistant Secretary  
Mr. Petersen, General Counsel  
Mr. Oltman, Deputy General Counsel  
Mr. Mannion, Assistant General Counsel  
Mr. Axilrod, Economist  
Mr. Holmes, Adviser for Market Operations

Messrs. Balbach, J. Davis, T. Davis,  
Eisenmenger, Ettin, Henry, Keir,  
Kichline, Truman, and Zeisel, Associate  
Economists

Mr. Sternlight, Manager for Domestic  
Operations, System Open Market Account  
Mr. Pardee, Manager for Foreign Operations,  
System Open Market Account

Mr. Coyne, Assistant to the Board of  
Governors

Messrs. Kalchbrenner and Prell 1/,  
Associate Directors, Division of  
Research and Statistics, Board of  
Governors

Mr. Gemmill, Associate Director, Division  
of International Finance, Board of  
Governors

Mr. Beck, Senior Economist, Banking  
Section, Division of Research and  
Statistics, Board of Governors

Ms. Farar, Economist, Open Market  
Secretariat, Board of Governors

Mrs. Deck, Staff Assistant, Open Market  
Secretariat, Board of Governors

Mr. Forrestal, First Vice President,  
Federal Reserve Bank of Atlanta

Messrs. Boehne, Brandt, Burns, Corrigan,  
Fousek, Keran, Parthemos, and Scheld,  
Senior Vice Presidents, Federal  
Reserve Banks of Philadelphia, Atlanta,  
Dallas, New York, New York, San  
Francisco, Richmond, and Chicago,  
respectively

Mr. Danforth, Vice President, Federal  
Reserve Bank of Minneapolis

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1/ Entered the meeting prior to the action to ratify System  
open market transactions in foreign currencies.

Transcript of Federal Open Market Committee Meeting of  
March 18, 1980

CHAIRMAN VOLCKER. The meeting can come to order, gentlemen and lady. We have a lot of business to dispose of at the start and I will try to find my agenda, if you will excuse me a moment. We have the election of officers. First of all, we have the election of the Chairman--I keep getting reminded that this position is not statutory --and we need a nomination.

MR. SCHULTZ. Mr. Chairman, after great soul-searching until late last night, and contrary to the exhortations of many people around this table, I have decided to nominate Paul Volcker as Chairman of the FOMC!

CHAIRMAN VOLCKER. Do we have a second?

MR. PARTEE. Second. You saved him, Fred!

MR. SCHULTZ. Pressure will do it every time!

CHAIRMAN VOLCKER. Is there an objection? I shouldn't put it that way!

MR. TIMLEN. I move that the nominations be closed.

CHAIRMAN VOLCKER. Without objection. We need a Vice Chairman.

MR. SCHULTZ. Mr. Chairman, I nominate Anthony Solomon as Vice Chairman of the FOMC.

CHAIRMAN VOLCKER. This can't take effect until he takes office, so it would have to be dependent upon his April 1 inauguration date. Is there a second?

SEVERAL. Second.

CHAIRMAN VOLCKER. Without objection we will have Mr. Solomon become Vice Chairman upon his taking office. We have staff officers to select. As one of those staff officers, I would nominate Mr. Altmann to be Secretary. Perhaps Mr. Altmann will read the rest of the nominees.

MR. ALTMANN. Fine.

Assistant Secretary, Normand Bernard;  
General Counsel, Neal Petersen;  
Deputy General Counsel, James Oltmann;  
Assistant General Counsel, Robert Mannion;  
Economist, Stephen Axilrod;  
Adviser for Market Operations, Alan Holmes;  
Associate Economists from the Board:  
Edward Ettin;  
George Henry;  
Peter Keir;  
James Kichline;  
Edwin Truman; and  
Joseph Zeisel.

Associate Economists from the Reserve Banks:  
Anatol Balbach;  
John Davis;  
Richard Davis;  
Thomas Davis; and  
Robert Eisenmenger.

That's the list, Mr. Chairman.

CHAIRMAN VOLCKER. Apart from the fact that we seem to have a plenitude of Davises--pardon me? \*

MR. PARTEE. And no Managers.

CHAIRMAN VOLCKER. The selection of the Managers comes in a later agenda item. If there are no objections to those officers, they will be appointed. Now we need a Federal Reserve Bank to execute transactions for the System Open Market Account. That has traditionally, as you know, been the New York Bank. Do we have a motion to that effect?

SEVERAL. So moved.

CHAIRMAN VOLCKER. Without objection. Now we need to select the Managers. The present Managers are Mr. Sternlight, Domestic Operations and Mr. Pardee, Foreign Operations. Do we have a motion to [reappointment them]?

SEVERAL. So moved.

CHAIRMAN VOLCKER. Without objection those appointments are made. Now we need to approve the minutes of the last meeting. Do we have a motion?

MR. TIMLEN. So moved.

CHAIRMAN VOLCKER. Do we have a second?

MS. TEETERS. Second.

CHAIRMAN VOLCKER. Without objection, the minutes are approved. And I guess we are now to the report on foreign operations since the last meeting, Mr. Pardee.

MR. PARDEE. [Statement--see Appendix.]

MR. TIMLEN. Scott, you mentioned the possibility that some parties may be suffering major losses by reason of the decline in the price of gold. Would that include any major commercial banks?

MR. PARDEE. Well, not U.S. banks. A few of them have operations in gold, but they are mainly merchandisers of gold in that they buy from either the IMF or out of European markets, or in the past from the U.S. Treasury.

MR. TIMLEN. [What about] European banks?

MR. PARDEE. One or two European banks could be sitting on losses. On the other hand, they are very well capitalized. I think they can withstand such losses.

MR. WALLICH. Scott, you said that the fundamentals--inflation expectations, the current account, and so forth--were not in favor of the dollar. Do you see continuing strong pressure for the dollar to go up in the face of that?

MR. PARDEE. No, one of the reasons we repaid our debt so quickly was that there is the risk of a snapback. As I say, the only thing that is supporting us at the moment is really the interest rate differential. Market expectations toward the dollar are still very bearish.

MR. WALLICH. The question I would like to raise more broadly is, insofar as we do anything in the market at all, should we restrain the dollar more than we have? We share with the Bundesbank in the proceeds of their support operation. In any event, if there is a strong movement, one can't do very much. But if the dollar goes up, say, three pfennigs in one day, wouldn't it be better to absorb some of that?

MR. PARDEE. Well, the rise of the dollar has been almost totally during the European hours, and the Bundesbank has been prepared to <sup>in one</sup> operation or the other. By the time we come in, the market is pretty limp. We have been able to do small amounts. We haven't wanted to do too much for fear that the market psychology would turn against us saying: "Aha, the United States is trying to drive the dollar down again." So it's a very, very delicate question. On the other hand, the Bundesbank has had some of the same problems with the mark that we had back last fall when the dollar was going down and we were having trouble stopping the slide, even though we were intervening in big amounts.

MR. WALLICH. The market moves against the intervention is what you are saying. The dollar goes up in Frankfurt against the Bundesbank intervention and doesn't go up in New York despite the absence of intervention.

MR. PARDEE. We have been prepared to operate a little, but [the dollar] has been pretty steady in New York.

CHAIRMAN VOLCKER. We need to ratify the transactions since the last meeting. Do we have a motion? Second?

SEVERAL. Second.

CHAIRMAN VOLCKER. [Approved] without objection. You have a recommendation?

MR. PARDEE. For once I don't have to recommend any swap renewals. But I do have a rather complicated transaction to describe, so that I can be authorized to complete it. When the dollar came into demand in late February, early March, the Bundesbank supplemented its spot sales of dollars with forward sales of dollars against marks for delivery in early May. The choice of dates was related to the

domestic liquidity situation in Germany. Mark liquidity was expected to be more ample in early May than in early March, so the forward sales of the dollar would help mop up some of that excess liquidity. The total was equivalent of marks. Since the Bundesbank was sharing half of the mark proceeds of its spot sales of dollars with us at the time, and we had no idea how long the dollar would remain in demand, we asked them if they might also share the proceeds of the forward sales. It took them several days to come back with an answer; and when they did, they set some conditions that required consultations on our side within the Federal Reserve and with the Treasury. In the meantime the dollar continued to rise and the System continued to make good progress in repaying swap debt. In view of the Treasury's need for marks to cover the Carter notes, we finally decided to offer the forward marks to the Treasury, and the Treasury agreed. In response, the Bundesbank raised no objection. But after further review on their part, they insisted that the Federal Reserve as the central bank of the United States be the direct counterparty on the forward contracts rather than the U.S. Treasury.

Subject to your approval, the solution we have worked out is that the System would enter into two sets of forward contracts: one with the Bundesbank to obtain the marks directly from it, so that as the central bank of the United States we are sharing in that operation; and the other between the Federal Reserve and the Treasury to pass the marks directly on to the Exchange Stabilization Fund. These transactions would be at the same rates, so there is neither profit nor loss to the System. The reason I am laying this out to you is that the Bundesbank

As Manager, it is difficult for me to argue that these transactions would be

Exceptions have to be expressly authorized by the Committee. Consequently, I am requesting authority from the Committee to make an explicit exception to the rule so that we can complete the deal. The Treasury needs the marks since it still has a short position of \$3.3 billion of marks under the Carter notes. Since some of the Treasury's mark debt is at even higher mark rates than those on these contracts, the cost comparisons are not excessively unfavorable to the Treasury. Moreover, should the System need to incur additional swap debt before May, the Treasury is willing to cancel all or part of its purchases from us so that we could use the marks in repayment. The transactions are quite complicated but essentially mean that the U.S. authorities will gain an additional worth of marks to work with should the occasion arise. That's my recommendation.

MR. WALLICH. But at what cost?

MR. PARTEE.

I take it?

CHAIRMAN VOLCKER.

MR. PARTEE.

MR. PARDEE. Yes.

CHAIRMAN VOLCKER.

in today's markets,  
it's the Treasury who bears [the cost], and they want to bear it.

MR. PARDEE. We don't know where the rate will be in May.

MR. MAYO. Why does the Bundesbank

MR. PARDEE. It's a matter of that nature, yes. They prefer

MR. PARTEE. Was the Treasury a party to the original agreement, Scott? That is, did they agree that those forwards ought to be sold?

MR. PARDEE. No, but they were the ones who suggested that we should raise the question of this 50-50 sharing with the Bundesbank. As soon as they heard about it, they were the ones who pressed the Desk to inquire whether the Germans would be prepared to--

CHAIRMAN VOLCKER. It was the Bundesbank's decision to buy in the first place; but as soon as the Treasury heard about it, they wanted [to participate].

MR. PARDEE. There was no objection raised by Treasury, or for that matter by the Federal Reserve.

MR. WALLICH. Does that reflect the judgment of the Treasury on the outlook for the dollar?

CHAIRMAN VOLCKER. All this discussion took place when [the transaction] was at about the market rate. It's just that with the lapse of two or three weeks since the transaction took place it's no longer the market rate.

MR. BLACK. Scott, at what rate do we get these marks back [from] the Treasury, if we need them?

MR. PARDEE. Well, I am sure the Treasury would insist on a rate of around 175, 176. The average rate is 175-1/2 or thereabouts.

CHAIRMAN VOLCKER. I think we probably wouldn't want them back.

MR. PARDEE. No, if the situation arises, I will [undertake] a very complicated negotiation to avoid our getting stuck with them.

CHAIRMAN VOLCKER. Well, this seems more technical to me than real. The original transaction was at a market rate and what we are doing is back-dating in some sense--not literally back-dating, but it's no longer at the market rate. The Treasury wants the marks and we are a conduit. I don't see any big problem in this myself.

MR. WALLICH. I move we accept this.



CHAIRMAN VOLCKER. Is there any real question about it? I think we just have to write the exception in such a way so that the circumstances are clear as to the fact that this was not an off-market transaction when it took place.

MR. MORRIS. And we're not committed to buy them back from Treasury?

CHAIRMAN VOLCKER. No, I don't see that we should be committed. I don't understand that part. I don't see where we would want to buy them back. If we have to intervene on the other side, the Treasury can use the [mark] balances [it holds] and it would take the loss. I don't think we want to take them back at the off-market rate.

MR. PARDEE. Right.

MR. PARTEE. This was a transaction that was initiated by the Germans and it automatically involved us to the extent of 50 percent?

CHAIRMAN VOLCKER. It didn't automatically. They've been giving us 50 percent of their intervention at our request and this falls into that pattern.

MR. PARTEE. I see.

CHAIRMAN VOLCKER. They originated the intervention but they have been giving us 50 percent, and they will give us 50 percent of this. It just happens to be a forward transaction which hasn't been [consummated] yet. It falls into the regular pattern, but what is different about it is that it is a forward transaction.

MR. PARTEE. Forward, yes.

MS. TEETERS. Do they regularly engage in forward transactions?

CHAIRMAN VOLCKER. No, I believe they did it for liquidity reasons.

MR. PARDEE. Yes, liquidity.

CHAIRMAN VOLCKER. They were doing a lot of intervention and the effect was to drain liquidity. They didn't want to drain that much liquidity at the time, so they did a forward. That's why they did it, as I understand.

MR. PARDEE. In fact they are now

CHAIRMAN VOLCKER. I don't think they have done any forward transactions recently. This was all during a limited period. Well, without objection we will provide that exception. Mr. Sternlight.

MR. WINN. Paul, before you turn to that: What's our posture for the month ahead in this area as the markets bubble?

CHAIRMAN VOLCKER. Well, I think Mr. Pardee has described our present posture. We would certainly buy some marks, to the extent that the mark is at these levels and to the extent that it is strong in New York. But as he points out, it hasn't been terribly strong in New York. The Bundesbank has agreed to share with us their intervention, but we will pass it on to the Treasury at this point since we are out of debt and the Treasury is under water by whatever the number is now.

MR. PARDEE. \$3.3 billion. Yes, we can continue; and they are continuing to share.

CHAIRMAN VOLCKER. Do we have any mark balances now? We have a few mark balances, don't we?

MR. PARDEE. Yes, \$100 million worth of marks.

CHAIRMAN VOLCKER. Essentially, we will pass along our share of their intervention to the Treasury until the Treasury gets balanced. If the dollar remains that strong and indeed we do any intervention in New York, we will pass that on to the Treasury, too.

MR. PARDEE. Yes, everything. The problem will remain if the dollar comes under selling pressure. I think we are going to have to give quite a bit of ground before we start operating very vigorously in defense of the dollar because the Bundesbank certainly won't help us for a long ways down.

CHAIRMAN VOLCKER. There is a great concern in Europe generally about their currencies depreciating because of the internal inflationary repercussions, and everybody wants their currencies to appreciate at this point. I think it's only that our interest rates have prevailed here at the moment. But the danger is that they will raise their interest rates, which is one consideration we had in mind in handling our discount rate the way we did--not to give them such a strong signal for raising their interest rates. I am not sure we are going to avoid it anyway, but it was quite clear when I was over there last week that they were not looking forward with any joy to an increase in the U.S. discount rate. They felt it would force them to raise their rates.

MR. STERNLIGHT. Shall I proceed, Mr. Chairman?

CHAIRMAN VOLCKER. Yes.

MR. STERNLIGHT. [Statement--see Appendix.]

MR. MORRIS. Peter, would you have been able to come closer to the total reserve path if we had contemporaneous accounting?

MR. STERNLIGHT. I really don't think it would have mattered a great deal, President Morris. I have not regarded the lagged accounting as a significant impediment to achieving the [path], as long as we are able to make the kinds of adjustments we make in the nonborrowed path to bring speedier adjustments to the growth of the aggregates. I don't think it matters a great deal.

MR. MORRIS. Isn't it true that the one-week bulge in the money supply practically made it impossible for you to hit the total reserve path in the last three weeks?

MR. STERNLIGHT. Well, even with contemporaneous accounting, we are going to get bulges at times; and if we didn't provide the reserves, [the reserve needs] would be met at the discount window. The banks would have to borrow, or would have to do something, to get the reserves to meet their requirements.

MR. PARTEE. You do have to be prepared to change your nonborrowed path frequently, I take it, as these borrowings numbers come out in ways that are unexpected.

MR. STERNLIGHT. I think that is right.

MR. PARTEE. There will be a lot more of that in the future, too, Peter.

MR. STERNLIGHT. Certainly so, given the new look at the discount window.

MS. TEETERS. But, Chuck, how do you know which way it's going? If we are making an adjustment in the nonborrowed, borrowings go up. It's hard to see which one comes first here. If we lower the nonborrowed path, that almost dictates an increase in the borrowings.

MR. PARTEE. Well, that certainly is true. But I think we do it by looking at total reserves, too--by seeing what's happening in total reserves relative to our path. What I worry about is that there may be a number of necessitous borrowers. There may be a lot of nonmember borrowers who will come in once this bill passes. So we could have a surge in borrowing, which is not really a reserve balancing decision but just a portfolio balancing decision on the part of those institutions, that we would need to adjust for in our nonborrowed [path].

CHAIRMAN VOLCKER. There is no question that if new borrowers come in for emergency reasons or because they are new, we will have to make an adjustment to allow for that. But I think this elasticity in the borrowing numbers is very bothersome whether we are on contemporaneous or lagged accounting. The contemporaneous might help. When are we going to have our report, Mr. Axilrod?

MR. AXILROD. Well, at any time. Following the previous FOMC discussion, we looked up all our old work on the various proposals that the Presidents put forward. And we'd be prepared to bring the issue of lagged reserve accounting plus some of those other issues before the Board at any time. If the Board were going to consider it, I would suggest that it be done in such a way that if any change were made, it could go into effect when the new [law] goes into effect--that is, six months from the time of [its enactment]. So, in that time frame--within a couple of months or earlier--we would certainly be prepared to bring something to the Committee.

CHAIRMAN VOLCKER. We are going to be prepared to have a discussion of that at our next meeting?

MR. AXILROD. Do you mean on the other measures in addition to the lagged reserve accounting that the Committee has already discussed or just--?

CHAIRMAN VOLCKER. What are they?

MR. AXILROD. Well, lagged reserve accounting, staggered reserve settlements, and a few other things.

CHAIRMAN VOLCKER. You are going to be prepared with all of this?

MR. AXILROD. Well, we could be.

CHAIRMAN VOLCKER. Let's try to do that. I think it's a major hazard to introduce something that is going to be as difficult as this for the banks to handle on top of all this other stuff that we have been giving them.

MR. AXILROD. My only point was that if the Board and the Committee wanted to do away with lagged reserve accounting, the time to do away with it is when the whole new reserve system goes into effect, [when it is] applicable to other institutions.

CHAIRMAN VOLCKER. I understand that consideration. Mr. Roos.

MR. ROOS. I think my question was probably answered, Mr. Chairman. As I understand this process, every day you have a total reserve path target in mind, right?

MR. STERNLIGHT. I would say that what we have in mind from day to day is more of a nonborrowed objective. Although as I described, in certain circumstances, such as when we get a bulge of borrowing over the weekend that may have been caused by banks anticipating a discount rate action, it seems sensible to come in below, let's say, a nonborrowed interim objective.

MR. ROOS. But the figure on borrowings is available to you on a [daily basis]?

MR. STERNLIGHT. Oh, I get a tentative figure every day, yes.

MR. ROOS. So, if you have a total reserve figure in mind and you know what the borrowings are, can't the adjustment almost automatically be made on the nonborrowed side to give you the total? If you know borrowings and if you know what total reserves should be, then can't you simply adjust the nonborrowed part of this to give you the total reserves you want?

MR. PARTEE. That's where the lag comes in. We have to meet the [required] reserves.

CHAIRMAN VOLCKER. We know the required reserves; we can't change the required reserves for that particular week. And the required reserves govern the total reserves.

MR. ROOS. I recognize that. But if we offset, or if we don't supply the required reserves, what happens? Do we have to accommodate the needs of the banks? Or could we not stick by our total reserve target, and if they are short, they would have to scramble to adjust their operations to what we want to do.

MR. STERNLIGHT. If we don't provide the reserves in nonborrowed form, they will have to get the reserves either through borrowings or be deficient in their reserves.

MR. ROOS. Is that a bad thing?

MR. STERNLIGHT. Well, it depends on what degree of pressure we want to impose on them at that moment.

MR. ROOS. Are we fearful that interest rates will [rise]?

MR. STERNLIGHT. The Committee has set bounds on the funds rate. If total reserves were the overriding objective, bar nothing, then we could drive interest rates up to just about any point, I would think.

CHAIRMAN VOLCKER. And even then we can't affect total reserves. The banks are just going to borrow. What we can affect is how much they borrow in any particular week.

MR. WALLICH. But we can affect the degree of pressure they are under so that they will start making adjustments.

MR. ROOS. Well, we do want to do that, don't we?

MR. WALLICH. Yes.

MR. STERNLIGHT. And we did that.

MR. PARTEE. I think we get an arithmetic impossibility if total reserves are set and we change nonborrowed reserves for every dollar change that occurs in borrowings to try to go along a path we have in mind for total reserves. It makes it impossible for the banking system to balance, given the fact that we have a two-week lag on deposits. And they would be in violation of the law.

MR. WALLICH. Well, they can [have a] reserve deficiency for a week, for a little bit.

MR. PARTEE. But it's not very big.

MR. BLACK. The important point really is the one you made a while ago, Chuck, about the need for reassessing the nonborrowed reserve target more frequently. I was on the call and I sensed that we really ought to be doing that; we did speed it up last month, but I would like to see even more.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLEs. [Unintelligible] keep the level of borrowed reserves at about what we would hope to have it. And to the surprise of most, if not all of us, the necessity of frequent adjustments just

didn't come along for a long time. It looks as if perhaps February might have been the month when it could have been used. The question, as you look back in a little post-mortem, Peter, is whether it would have made any difference. Would it have helped the cause, so to speak, in preventing total reserves from getting too big, if we had done what we thought we would have to do on that October 6 game plan, which is to put the discount rate up?

MR. STERNLIGHT. Well, of course, the discount rate was moved in the middle of February along with the Desk taking measures to impose greater reserve restraint. There was a certain amount of pressure that emerged almost automatically out of the process just by our sticking to our nonborrowed path when the banks were demanding additional reserves. That automatically imposed some increased need for borrowing. And then a further downward adjustment was made in the nonborrowed path to increase the degree of pressure, and at about the same time the discount rate was raised. So by forcing the banks to borrow--I think it was around \$1.8 billion--at an even higher discount rate, we put still greater upward pressure [on rates]. What we got, as I described, was a very substantial move in short-term rates of 3 or 4 percentage points over a few weeks. And I think it got some banks feeling that they were staring very hard at the possibility of a crunch and the prospect of just not being able to fund themselves. So in that sense the program is working; it has [produced] very real restraint for the banking system. I don't know that bigger moves or earlier moves in the discount rate would have done anything more than was being done [through our operations]. I don't know that we should have [done] more because I think we were imposing quite a bit of restraint.

MR. BALLEES. One other question, Mr. Chairman. I would like to ask Steve something in this case, in conjunction with the Bluebook alternatives. Steve, would it be reasonable or even feasible for the staff to attempt to estimate a level of the discount rate that would be consistent with the money growth targets?

MR. AXILROD. Well, I share much of what Mr. Sternlight says. If you want to estimate an interest rate that would produce these results--I was hoping this method would get away from that a little--it seems to me that, if anything, it would be more like the federal funds rate. In essence, if you look over a long enough time period, it doesn't matter very much what part of the total reserves is supplied by nonborrowed reserves and what part is borrowed. What really matters for determining the money supply is the amount of reserves, the total base out there to support money in some multiplier sense. And over a long enough period, it can't really matter whether that's through nonborrowed reserves or borrowed reserves. In the very short run because of this mix, with required reserves fixed, it does matter because it affects the behavior of the funds rate given the discount rate. But if we put in a high discount rate, then for any given total reserves we would have less borrowed reserves and more nonborrowed. If our estimate of the discount rate is low, we'd have the reverse situation. So, while we could do that, we would simply be changing the mix between nonborrowed and borrowed reserves for any given level of total reserves that would support the money supply. I don't think that would be very helpful to you; we would be glad to do it, of course. I think in February the alternatives before the Committee were: making an adjustment in the funds rate fast by

raising the discount rate; making it more moderately by gradually lowering the nonborrowed path; or making it even more moderately by keeping the nonborrowed path and letting a gentle rise in borrowing take place instead of a rapid rise. What was actually done was to have a small rise in the discount rate and a reduction in the nonborrowed path, which was somewhere in between all those alternatives.

MR. BALLE. Well, if I could, I'd just raise one more point. In asking my own staff to review what went on during that February period, it seemed pretty clear to us that the staff here and in New York had done a fine job of guessing what the multiplier was going to be, what the total reserves should be, and what the nonborrowed path should be. There was very fine work on that. Yet the net outcome was that total reserves got out of hand on the up side for a while. What I am trying to get to the bottom of, with the benefit of hindsight, is how you and Peter now think that could be headed off in the future.

MR. AXILROD. Well, our views are probably marginally different. A difference is that I might allege that we could hit the total reserve path week to week. I don't think it's very important to do it, but we could without lagged reserve accounting. But we'd have to have very large movements in the federal funds rate because we'd have to force the banks, within the statement week, to adjust their deposits to the total reserves we'd put out there. We'd have to force them to do it. Without lagged reserve accounting that is possible. With lagged reserve accounting, that could also occur. If we allow enough pressure on the funds rate, they could make the adjustments in deposits but we just won't see it in total reserves until two weeks later. So within a very short-run period it would look as if we were missing our total reserves; but actually we'd be getting adjustments in deposits that would be [evident] in required reserves two weeks later and we'd really not be off very badly. We would just be over path for a while and then we'd be back on path. That's the essence of what Mr. Sternlight is saying and I wouldn't quarrel with that particular statement. Indeed, the money supply is coming back on target now, or seemingly so, if March turns out as we are projecting it. There has been a rapid response to the rise in the funds rate that has occurred, just as happened in October, which may be a coincidence or it may be that the lags [in response to changes in] the funds rate are not six months [but are closer to] one day. It's hard to believe the latter but something like that has happened for two successive periods. I am not sure whether I have answered the question, but I think I at least came close to it.

MR. MORRIS. May I ask Steve a question? The advocates of contemporaneous reserve accounting argue that there would be less volatility in the funds rate than under lagged accounting. Do you subscribe to that?

MR. AXILROD. Oh no, I think there would be quite a bit more, for one reason. The one [internal] reason is that Mr. Sternlight really won't be "able"--and I put the word in quotes because I don't mean that he's really managing the funds rate--to adapt his operations as readily because in the current week he won't know required reserves. [Suppose] this week we're going to provide \$100 in total reserves. Given the fluctuations in deposits that occur from week to week, we really won't know whether the required reserves in the week

relative to the \$100 in total reserves would be \$20 or \$90. If they turn out to be \$20, Mr. Sternlight is going to find that as he puts in nonborrowed reserves, there are going to be huge declines in borrowing and huge declines in the federal funds rate. And he's not going to have any alternative but to chase those borrowings down and put in more nonborrowed. Because of the volatility of deposits week to week, I think we'd be certain to get more fluctuations in the federal funds rate. However, with the system we're now operating on, where he knows required reserves and we make adjustments on an average path for a four-week period, we make those adjustments so that we [take into account] the required reserve pattern that we know for certain over the two weeks ahead. And we tend to make the borrowings the same in each of those weeks. So we let nonborrowed reserves vary with the deposits while tending to hold the borrowing stable in an average path for a four-week period. I know that sounds like gobbledygook, but it is what we do.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I wonder if I may ask two questions? The first one is to Steve. Steve, on contemporaneous reserve accounting, how much of a change in deposits would you need in order to sweat out \$1 of reserve deficiency?

MR. AXILROD. I am not sure I get the gist of your question, Governor Wallich.

CHAIRMAN VOLCKER. It depends on what the multiplier is.

MR. AXILROD. The multiplier on demand deposits at the moment is roughly 6. So if we took put in \$1 of reserves, we ought to get \$6 more, roughly, in demand deposits. But that is not certain; if we put in reserves, they may end up in currency or anywhere else for that matter. But that's the multiplier on demand deposits; it's a lot higher on time deposits.

MR. WALLICH. The point I am trying to get at is: Isn't the additional adjustment you get from contemporaneous reserve accounting relatively small? You need a very large movement in deposits in order to overcome a small deficiency or surplus of reserves.

MR. AXILROD. Contemporaneous reserve accounting, as nearly as I can tell, does only two things for you. First, it absolutely can remove interest rates in some sense from your consideration. If you believed that there was a multiplier that the staff could predict, you could set total reserves; you'd have to chase borrowing up and down but you could come closer to hitting that total reserve target in a given week. Lord knows what interest rates you'd have, but you might have the money supply. So the interest rates would be forced to adjust to the reserves. We wouldn't be doing what we do now, which in some sense is to make adjustments in nonborrowed reserves to deliberately force more interest rate pressure on the system. The system would evolve its own interest rate pressure either up or down as we put in the total reserves. So contemporaneous would do that for you; it would remove some little element of prediction we still have as to what interest rates we want to see in order to achieve the money supply [objectives]. That element is left in lagged reserve accounting. The other thing it does, of course, is to speed up the



response by 2 weeks. The latter isn't all that important presumably because 2 weeks out of 52 weeks is not any big deal.

MR. WALLICH. And you can anticipate it anyway but--

MR. AXILROD. What it really does, in my mind, is to remove the necessity of making judgments about where you want interest rates to be. But that's a judgment the Committee may not want to remove.

MR. PARTEE. We'd have to be willing to let the interest rates go anywhere.

CHAIRMAN VOLCKER. We will have to have an exhaustive discussion of these questions when we put contemporaneous reserve accounting squarely on the table, so perhaps we shouldn't waste too much time now. I don't think we are going to change [our procedures] at this meeting.

MR. WALLICH. May I ask my other question? Peter, what determines your decision to buy coupons? You mentioned that you bought nearly \$1 1/2 billion.

MR. STERNLIGHT. Well, we were in the midst of a period of sizable reserve provision and it was a judgment that we should divide up that purchase. We anticipated the need to provide for an outright increase in the portfolio of some \$1-1/2 billion. It seemed appropriate to do the bulk of it in the bill area, but we had not bought any coupon issues for a few months and just in accord with the past dispersion of our buying it seemed appropriate to do some portion of it in coupons.

MR. WALLICH. Would you have done about the same had the bond market been different?

MR. STERNLIGHT. We want to keep in mind that we don't want to buy at a time when issues are very scarce and we'd have a sharp impact on prices. Certainly the fact that the coupons were available would make some marginal difference in our decisions.

MR. WALLICH. Yes, so you were stabilizing the market?

MR. STERNLIGHT. We did a bum job of stabilizing!

MR. PARTEE. Unsuccessful.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. I would like to ask what may be the same question John Balles asked but in a little different way. Had we raised the discount rate early in March, having in mind that through the period total reserves would be over [path] by about \$700 million plus, would you not [conclude] that we'd have come closer to the total reserve path and that the adjustment would have been a bit quicker? I guess the alternate question is: What would you have projected for interest rates? Would they have been any higher absent the anticipation [of a discount rate move] that was going on?

MR. AXILROD. If you had taken a further upward discount rate action from 13 percent, say, to 15 percent, I would have predicted a faster adjustment of the money supply only if that rise in the discount rate also meant that you were going to permit the federal funds rate to rise substantially. If you weren't going to permit the federal funds rate to rise substantially, I would assume that that upward adjustment in the discount rate would merely have meant that total reserves would be the same over time but with less borrowing and more nonborrowed. But if you had permitted the funds rate to rise, I would assume banks would have tightened loan terms and maybe sold off some assets, resulting in lower bank credit, lower money growth, less required reserves and, therefore, less total reserves down the line several weeks later.

CHAIRMAN VOLCKER. I hope we can proceed here with some dispatch. Mr. Eastburn.

MR. EASTBURN. I have just an informational question. Steve, some time ago there was discussion about having some papers on the function of the discount mechanism, the rate and so on. We now have a new situation with the surcharge and also the likelihood that we'll be making loans to other institutions--in a couple of weeks, possibly. In that connection, what are your plans on this background material?

MR. AXILROD. Well, I have seen first drafts and, in some cases second drafts, of a sizable number of papers. Of course, the Board's decisions have in a sense "prejudiced" some of the conclusions. [Secretary's note: These decisions involving special reserve and other measures were made in conjunction with the President's anti-inflation program announced on March 14, 1980.] We were proceeding with our study and the analysis on a schedule that got interrupted because of other work. We were trying to get some materials before the Committee at this meeting. Whether we can do so at the next meeting or if it will be after that I am not certain, in view of what is going on. But we are on course. We weren't including emergency borrowing in that study because that is taken care of in other ways. This was really a study of how the discount window might best interact with the present reserve [supplying] methods.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Peter, on the unsuccessful unwinding of some of these GNMA futures with the failure of a firm or two: Do you see any more problems ahead on that score with [more of those market instruments] reaching maturity?

MR. STERNLIGHT. In a way, I have been surprised, given the extent of rate moves in the market, that there haven't been more problems cropping up in the GNMA area. It may be that they had enough of a scare last October when there were fears of problems in the GNMA market. From that point on, I have had the impression that activity has been curtailed in those GNMA futures. Some of the regulators have gotten after their constituents--the S&Ls and credit unions and banks to some degree--to warn them about undertaking investment activities that may not be suitable to their investment objectives. But, at the same time, I can't rule out the possibility that some of those problems could crop up again. I don't have a sense of any pending disaster there, but there could be some more [unintelligible].

CHAIRMAN VOLCKER. Let me just say on these questions on discount rates--I didn't hear the last answer Mr. Axilrod gave--that I am not sure it makes a great deal of difference whether we move the discount rate or not, except for its signalling influence, which might have been considerable. That's because we could adjust the borrowings, presumably, to achieve the same result. The reason the discount rate was not moved--let's be clear about it--is that we were waiting for this program, and it seemed inappropriate to raise the discount rate when the Administration was trying to negotiate these pending changes. The judgment was either right or wrong; but it was a judgment we made. It certainly would have been disruptive to that process if the discount rate had been raised in the middle of it when we said we'd have a coordinated announcement. Mr. Kichline.

MR. ALTMANN. Ratification.

CHAIRMAN VOLCKER. Oh, we need the ratification of domestic operations.

MS. TEETERS. So moved.

CHAIRMAN VOLCKER. Second?

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection they are ratified. Mr. Kichline next and then I think we will go straight to Mr. Axilrod. We can then have the Committee discussion in which I would like to get as much flavor as you propose to give in the limited time we have of what is going on out there in the financial markets and in the banking system. We get all sorts of complaints about the availability of farm credit or small business credit or mortgage credit. It is very hard to judge, I think, [the degree] of total restraint we have and the kinds of problems, institutional and otherwise, that are arising. The more flavor on that we can have, the better.

MR. KICHLINE. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Mr. Axilrod.

MR. AXILROD. [Statement--see Appendix.]

CHAIRMAN VOLCKER. In connection with that distinction--the willingness or need of banks to borrow at the discount window--I think it is important that we all reiterate publicly or otherwise the fact that this change in the discount rate procedures does not imply any greater willingness on our part to tolerate borrowing. I think your discount officers ought to make that point to borrowing banks rather explicitly. We don't know how they will react. One can argue it either way. But any tendency for them to think that the window is open because the rate, at least the surcharge, is closer to the market rate, should be discouraged or we will get a perverse reaction from this action. I think a little more than usual calling to borrowing banks may be justified under the circumstances to point out to them rather directly that this is no invitation to borrow.

Let me just say in connection with setting the stage here that the Chase Manhattan Bank said it is raising its prime rate to 19

percent today. At the same time it is instituting a small business base rate which remains at 18-1/4 percent, effective immediately. They used some language [in their announcement] indicating that they think this is consistent with the philosophy of [the measures] announced by the Federal Reserve. They said they have some special [concern] for small businesses and they're acting to ease the strains that small companies face in borrowing money. The special rate applies to companies with assets of \$1-1/2 million or below and bank loans of \$1/2 million or below. With total bank loans of \$1/2 million, that implies that a company is borrowing one-third of its total assets. The bank said the small business rate would apply to several thousand of its smaller customers.

MR. ROOS. They've ignored the farmers, haven't they?

CHAIRMAN VOLCKER. They don't have a lot of farmers in Manhattan.

MR. SCHULTZ. There may be more farmers in Manhattan, though, fairly soon!

MR. TIMLEN. With their \$10,000 tractors.

CHAIRMAN VOLCKER. We can have a general go-around with comments. But apart from the general business situation, any comments that you have about how far this restraint has gone and how far it needs to go and what the special problems are, as I said, would be very welcome.

MR. SCHULTZ. May I ask Steve a couple of questions first? Steve, I'm a little confused about the relationship between M2 and the other aggregates [in the Bluebook alternatives]. First of all let me ask this question: Is the relationship between the new M2 and GNP pretty similar to the relationship between the old M2 and GNP that people often looked at? I'll get that answer first.

MR. AXILROD. My memory is that we have ended up with a somewhat better relationship. I had better not answer; my memory is a little off on that.

MR. SCHULTZ. For the second more important question, let's look at alternative B. The implied rates of growth for February to June for M-1A and M-1B were lowered by 1-1/4 points from the growth rates for December to June, but the growth rate for M2 has only been lowered by 3/4 point from 7-3/4 to 7 percent. Now, given the new actions, with the likely impact on money market funds, are we to [understand] that you believe there will be strong growth in MMCs and 2-1/2 year certificates? How do you get that strong--

MR. AXILROD. It may turn out that we seriously underestimated the growth that would occur in money market funds over the first two months of the year. So there was a much bigger expansion in M2 than the Committee, in effect, wanted at that time. We have assumed that growth in money market funds would drop from here on to a rate just slightly above what it was late last year. However, that was without taking into account the latest 15 percent marginal reserve requirement on those funds. Taking that into account, we would think that their growth would continue but at a much slower

rate. Using a rule of thumb that Governor Partee introduced to the staff many years ago--and it's been difficult to find a [better] one-- I would say that something like 50 percent of that money would go into M2 type deposits and another 50 percent would go into large CDs and Treasury bills that are not in M2 but are either in M3 or liquid assets. I don't think that's too bad a view because roughly 50 percent of the liabilities of funds are due to institutions and another 50 percent to individuals. So I would expect that, if anything, the 7 percent M2 figure you are referring to may be a shade stronger than might develop in light of the program. But I wouldn't expect the difference to be large. That's as far as we've been able to go [in our analysis].

CHAIRMAN VOLCKER. If I understand these inter-relationships correctly, the December-to-June figure you show has a monthly base, but if it were on a quarterly base the way the yearly target is, the implied 4th quarter to 2nd quarter figure for M-1A in alternative B, for instance, would be 5-1/4 percent.

MR. AXILROD. That's right. Those rates are on--

CHAIRMAN VOLCKER. That's somewhat above the midpoint [of our long-term range].

MR. AXILROD. That's correct.

CHAIRMAN VOLCKER. And even alternative C is above the midpoint.

MR. AXILROD. Slightly, that's right. That would be 5 percent, just given the way the quarterly averages work out relative to these monthly patterns.

CHAIRMAN VOLCKER. Steve, even with alternative C, growth would end up in the second quarter as a whole running slightly above the middle of our range.

MR. PARTEE. But well within the range.

CHAIRMAN VOLCKER. Well within, but above the middle of it.

MR. AXILROD. That assumes a very strong April, so we get the money in early in the [quarter]. If it didn't work out that way, it would be a little lower, I would think.

MR. PARTEE. Well, the April growth rate is only 8 percent in alternative C.

MR. AXILROD. I mean it is strong relative to the other months. But if [that pattern were] reversed, it would lower the quarterly average growth.

CHAIRMAN VOLCKER. Mr. Eastburn.

MR. EASTBURN. Just a quick technical question. It seems to me that April is rather critical to the decision we make today and I am trying to get a fix on your feeling about the probability of those

numbers. Your estimates and the New York staff's estimates, I gather, are somewhat different on this.

MR. AXILROD. I think the direction is the same; it's the magnitudes that are different.

MR. STERNLIGHT. New York has a stronger estimate for April, partly because of the tax refunds.

MR. EASTBURN. It's quite a bit stronger, isn't it? Is that the basis for the strong April in both cases?

MR. AXILROD. We did not put in any specific estimate for tax refunds because we haven't observed them having an effect yet in late February or early March when they began. If we put one in, we would add only a couple of percentage points, roughly.

MR. EASTBURN. And New York has them in?

MR. STERNLIGHT. Yes, that's part of the difference; I really don't know if that's the whole difference.

MR. TIMLEN. But [the difference] is very substantial, Peter, in April. Dave, New York's [estimate] is about twice what the--

MR. EASTBURN. Yes, there's a very big difference.

MR. STERNLIGHT. The overall difference is about 8 percentage points but my impression was that the tax refunds accounted for about 3 or 4 percentage points of that.

MR. EASTBURN. Steve, could you say anything about your feeling of confidence in that?

MR. AXILROD. I was hoping not to. I consider this as reasonable an estimate as a group of human beings working together might come to. I didn't give you the specifics, but it assumes roughly a \$1 billion increase in M1 in the week of the 19th, which is the week we're in, another \$2-1/2 billion in the week of the 26th, and then very little increase thereafter. But that gives us a high April figure because from February to the end of March M1 will have increased 12 percent, roughly, and that gets into the April figure. I wouldn't doubt, given our GNP projections, that we're going to have a second-quarter rate of growth close to what we've estimated here on average, something like 4-3/4 percent. Whether it's going to come with a large April or a large May or a large June, or whether it will be an even distribution among those months, I really can't be very certain. It would be misleading to say that I feel extremely certain about this; I don't. But I don't think it's unreasonable. It would be what a reasonable set of people would come to at this point.

CHAIRMAN VOLCKER. I think it's fair to say, in the light of history, that there is no feeling of certainty about any of these numbers.

MS. TEETERS. It's my understanding that a refund will feed directly into the money supply. Is that right?

MR. AXILROD. Well, there will be checks received by consumers. The uncertainty is what people will do with them. Will they deposit them directly in their savings and time accounts--in which case it will go into M2--or will they put them in their demand accounts? And if they put them in demand accounts, will they hold them for one or two days? In that case it will have some effect on M1 but a very small one. That is the reasoning [underlying our estimate]. If people put the funds into demand accounts, we wouldn't expect them to stay there long. Why would people want to hold more demand deposits? So, they would either transfer the funds to another asset, such as a money market fund or a T-bill or something, or start spending them. In that case, any little upward effect would begin coming down in May and June and July. The only evidence we've really had was on the tax rebate program where checks were sent out to people as a tax rebate; those very clearly had a discernable money supply effect. On these kinds of refunds, we don't have the experience that would enable us to be very certain about [the effect]. So, we are waiting for something to happen; we haven't seen it yet and we may not see it this whole--

MS. TEETERS. Well, suppose the refund is real and it occurs. Is that enough to knock us off of our money path growth?

MR. AXILROD. Well, as we said last time and this time also, we think the effect in the three months of March, April, and May might be on the order of 1 to 3 percentage points [unintelligible] and then unwinding to that extent in June and July and piddling out in August. That's our estimate of what might happen. But we haven't deliberately put that in.

CHAIRMAN VOLCKER. You have a big seasonal in April to take care of this in a normal way?

MR. AXILROD. Yes, but the refunds this year are estimated to be about \$12 billion above the average of the last two or three years. So it's more than normal.

CHAIRMAN VOLCKER. What is the normal?

MS. TEETERS. They are estimating about \$46 billion, I think, so \$33 billion or so must be normal.

MR. AXILROD. I don't remember the exact number. I don't know whether Darwin [Beck] has it. Well, this year we're estimating the individual tax refunds to be somewhere on the order of \$48 billion. In 1979, total refunds were \$36 billion. Reading back, in recent years they were, in billions of dollars, 36, 34, 31, and 29. So you can see that it's a quantum jump this year on the order of \$12 billion. In March of the previous four years the refunds were around \$9-1/2 to \$10 billion; this year they will be around \$13.7 billion, according to these estimates. So it's a jump of \$4 billion in March and roughly \$3 to \$4 billion in April.

CHAIRMAN VOLCKER. Who would like to make some general comments?

MR. WILLES. I would just like to respond to the one question you raised about farm credit.

CHAIRMAN VOLCKER. Well, respond more generally, too.

MR. WILLES. We have recently done a survey of our country banks and they tell us they are as tight as a drum, and the farmers tell us [the banks] are as tight as a drum. Yet we have very few of the country banks trying to pass on those loans to the city banks, which are not tight as a drum. When we get behind that, [we find that] they're passing them off like crazy to the PCAs and so on, but they're reluctant to pass them off to their city correspondents simply because the price is so high. So it's not really a question of availability in the normal sense, but a question of their unwillingness at least to this point to try to pass those higher rates on to their farm customers who are used to substantially lower rates. Now, I don't like the implication of that, in terms of the direction we seem to be going, which is to give preference to small businesses. But I think that is the real issue in their mind. It's not that the money is not there; it's just that they're unwilling, so far at least, to contract for the higher price.

The only other comment I would make is that, like many others, I was disappointed in the movement in the President's program for fiscal 1980. That puts a little extra burden on [monetary policy] for this year. Therefore, to the extent that we do err, I think we're going to have to err on the tighter side rather than the easier side. For fiscal 1981, I favor the reverse of that. If the deficit in fiscal 1980 is around \$35 to \$40 billion and then in fact [the budget] really does get balanced in fiscal 1981, that's a \$35 to \$40 billion [swing] in one year. That strikes me as a little larger than we've normally accommodated and unnecessarily runs the risk of aggravating whatever recession we're in. It's too bad [the effects] weren't evened out a little, with a little more in '80 and a little less in '81. I think that has implications for us in terms of how hard we press during the next few months.

MR. SCHULTZ. On a cash basis, isn't the budget going to be in some surplus between April 1 and the end of the year?

MR. MAYO. Yes.

CHAIRMAN VOLCKER. Yes, but it normally has a big seasonal.

MR. SCHULTZ. I understand that, but just on a cash basis--

MR. MAYO. May I piggyback on Mark's comments for a minute? On your agriculture point, Mark, I wasn't sure I followed you. Is it that the banks are not making loans at close to the prime rate but are falling further below? Is that what you're saying?

MR. WILLES. Well, the country banks have loaned out about everything they have. But typically, now, given the current prime rate, the loans are at below prime, and they're reluctant to pass those on to the city banks.

MR. MAYO. Well, the city banks won't buy them except at a discount--

MR. WILLES. That's right.



MR. MAYO. --is what you're saying. We have that same experience, and the banks in our area are very tight.

CHAIRMAN VOLCKER. The country banks?

MR. MAYO. Yes, the country banks. There is some complaint, too, on the way the Farm Credit Agency credits enter into this. Some of that is not credit we're trying to discourage, like Farmers Home Administration per se. The more Farmers Home Administration does, the less of that type of credit the commercial banks will do, and they are restive about that even though they are tight.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Mr. Chairman, our staff has about the same economic forecast as the Board's staff. I have a gut feeling that if the forecast is wrong, the result is likely to be a deeper recession. I am thinking primarily in terms of the financial strains that the system will be under. I think we've all been amazed at the willingness of consumers and businessmen to take on loans at extremely high rates. And it seems to me the counterpart of this is that we may go into a recession [with] an awful lot of strains that are likely to lead to a deeper recession. One sector in particular that is showing great strains even in a forward moving economy is the savings banks; the situation in New England is getting critical. I was a little shocked yesterday to find out that they may be in a position to have ordinary access to the discount window within as little as two weeks. If that's the case, we have an awful lot of issues to resolve. As you know, in the past we have not loaned to organizations that were clearly insolvent. The fact is that all the savings banks in New England probably are insolvent if their assets are valued at current market rates.

MR. PARTEE. That's true of many banks, too.

MR. MORRIS. It's true of banks, too, but it's much more the case with the savings banks, particularly in New England where the average yield on their portfolios is very much lower than on the West Coast. That's because (a) we've been a slow growing region; and (b) New Englanders don't change their houses as frequently as people in California do. That has led to a very old and very low yielding portfolio. So, not only do they have liquidity problems but they have very serious earnings problems. Most of the savings banks in New England will probably show a deficit in earnings this year. There are other complications. There is this new dual rate which was set up to deal with large commercial banks. I think that is perfectly fine, in light of the fact that that's where the growth of credit has been most pronounced. But some of the most seriously troubled savings banks in New England have assets in excess of \$500 million. And the question is: Do we want to charge them the premium rate? Another problem is that most of the savings banks in New England are not insured by the FDIC. We have a state fund which amounts to about \$250 million. What do we do when that fund is approaching its limits? We're going to have an awful lot of issues in this whole area of lending to thrift institutions coming down on us very soon that will need to be addressed.

CHAIRMAN VOLCKER. What do you conclude from all this for our current posture? Tighter, easier, unchanged?

MR. MORRIS. Well, I think our current posture is doing the job. I would advocate the alternative B approach. I don't see where the situation now requires a tighter posture. We have to evaluate what needs to be done. And I think we're going to see, as the staff is forecasting, a major collapse in housing in the next few months.

CHAIRMAN VOLCKER. Mr. Timlen.

MR. TIMLEN. Mr. Chairman, I haven't talked to [any business contacts] since Friday, except to that group of bankers who were here yesterday. But I must say that through Thursday of last week, businessmen, and by that I mean mostly industrialists, were still telling us in New York that they have great confidence in 1980 being a pretty good year--maybe not a record year but a pretty good year. It's true that the money market banks and the medium size and large regional banks have all been approached for, and have granted, loan commitments. And I know a few of them are very uncomfortable about meeting those commitments. In upstate New York some of the country banks have been expressing a great deal of concern about the effect of the current level of interest rates on local small businessmen. I think local small businessmen are not unlike the farmers in the Midwest. There are stories that automobile dealers are just closing their businesses because they can't finance their inventories; rather than go bankrupt, they retire. We have the impression that inventories are generally modest, although for some small retailers they are pretty minimal. I have the impression that in New York City retail sales are pretty good, but that may not be the case outside of the city. We've had some indications that in the first two months of the year there have been price increases, particularly by the large grocery chains. Some people explain that as the reason for all the coupons we're getting in our Sunday newspapers. In effect, it's giving back the anticipatory price increase.

We also have in our area the same grave concerns that Frank has in Massachusetts and New England generally. Our thrifts are in very bad shape. Three of the ten largest mutual savings banks in New York were in the red for 1979, and probably more will be in the red for 1980. It is disintermediation on the one side and terrible earnings on the other side. My own feeling is that if the consumer hadn't been running out of gas before last Friday, he certainly has had his accelerator taken away from him as of Friday. On the other hand, though, we're hearing that some companies are accelerating the timing of their annual wage increases. For example, if an annual review was to be in July or August, they're bringing it forward. So the consumer may have a little extra money in his pocket. The Board staff's projections of the outlook for the next 15 months seem pretty reasonable. In all the circumstances, my thought is that we should hang in there, which is probably what "B" does. That would be my idea of hanging in there.

CHAIRMAN VOLCKER. Mr. Forrestal, what wisdom do you bring us from Atlanta in your first presence here? Welcome.

MR. FORRESTAL. Thank you, sir. It's nice to be here at this interesting time. Shifting to another part of the country, Mr.

Chairman, the Atlanta District shows a remarkable reversal in attitudes concerning the economic outlook, it seems to me. Just a month ago our directors and businessmen generally were virtually discounting any recession, even a mild one this year. But in a month's time that sentiment has changed remarkably, as I say. They now almost uniformly see a recession developing and perhaps a deeper recession developing later this year. That even comes from our South Florida directors who had been reporting very, very bullish conditions right through last Friday. These sentiments, of course, were voiced before the President's program and the Federal Reserve program. It's interesting to note that this change is attitudinal and not based on any real change in basic economic conditions. Conditions in the District generally are about the same as they were, although, of course, we have had some softness in real estate sales and construction activity and a slowing in retail sales. That has been reflected, too, in a less rapid run-up in bank credit than in other parts of the country. But the perception of the future is that we're in for a very difficult time. Our business people and directors see automobile dealers, farmers, small business people, and thrifts being hurt pretty badly and I think there is a real fear at this point of a credit crunch coming along. While I don't have any data, and my staff hasn't given me any data about small banks, I have an intuitive feeling that some of the small banks in the District are probably in much the same condition as savings and loans, although perhaps not to the same degree. My personal feeling, after hearing all of this from people around the District, is that the pessimism is perhaps a little overdone. Recession, in my judgment, would not be all that bad if we are going to get prices under control.

In terms of policy, it seems to me that we've got to get the monetary aggregates under control. February was perhaps a one-month aberration, but there was a run-up in the aggregates. That, together with negative market reaction to the President's program, is really going to fuel inflationary expectations. Indeed, as has been remarked here, with energy costs increasing in the short term we could have an increase in inflation. That is bound to cause consumers to lack confidence in what has been done by the Administration, and we could have an increase in inflationary expectations with the obvious results. So my judgment, Mr. Chairman, which is a little different from the staff's at the Atlanta Bank, is to err on the side of greater restraint. While alternative B seems to me a viable alternative, whereas I would not consider alternative A to be viable, my preference would be to go for something along the lines of alternative C to demonstrate in the near term to the markets that we're going to continue with this program of restraint.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, we are in general agreement with what the staff has [projected]. If we were to shade it a little, we'd shade it along the lines that Frank Morris described because of the unrest we see in financial markets, along with weaker housing and also probably weakness in investment, all of which we think may be more than the staff is estimating. I would add one other caveat and that is the feeling on our part that the international situation may be weaker than is generally being assumed. So we would shade the forecast toward a little deeper decline than the staff has indicated. By the same token, we would expect perhaps a more rapid recovery. The

staff is actually showing no growth in real GNP between the fourth quarter of '80 and the fourth quarter of '81, and we think [GNP growth] will probably be positive.

On the policy side, it seems to me that the best thing we could do is to continue the policy we've been following. I think you said it all, and very well, yesterday before those bankers when you stressed that the backbone of our policy still remains our efforts to control the aggregates. Not everyone heard you yesterday; there may be some general doubt that we'll do that and some expectation that we'll back away. So, one could make a case for going with alternative C. But it seems to me that alternative B is strong enough to underscore our determination. The rates of growth in the aggregates for the last part of that six-month period are substantially below what we actually had in the first three months, or think we had in the first three months. They are below our targets, so "B" seems to us to be the best of the alternatives.

So far as the federal funds range is concerned, I would prefer to drop the top and also the bottom of that range. I think we are now to the point where we can do that. I would not want to raise the lower end, a possible alternative suggested in the Bluebook, since I would like us to be in a position to let rates come down pretty fast, if they do tend to do that in the face of a controlled set of growth rates in the aggregates. I am sure that the Committee is not going to agree to abandoning that range; against that background, 11-1/2 to 18 percent looks about right to us.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Mr. Chairman, the crosscurrents are so extreme that it's difficult to sort them out and get a fix, particularly with last weekend's adjustments not being factored into many people's thinking. Three or four things, I think, are interesting. One is that we turned off commercial construction--that is, apartment houses, office buildings, and so forth--completely in October, and it turned back on in an unbelievable fashion in January and early February. We've turned it off again, I think, really in the last couple of weeks; there are just no deals being made. But the profits picture that is coming through on the deals that have been made are so unreal that it's almost unbelievable. With the acceleration of rents and with [builders'] fixed costs not moving up, the flows back to profits are very, very high. That's particularly true where tax relief occurred, in California and Texas and places like that. In spite of increased operating expenses the profits picture is almost unbelievable. So, if we get any stability in [interest rates], my guess is that those [activities] will explode on us again as building picks up.

The second thing I'd report is that the major chemical companies are showing profits in the first months of the year, and I've seen figures for month-to-month developments. While these are worldwide operations and one can't sort it out [for individual countries], it was interesting to me that the price increases from January of last year to January of this year were over 30 percent. Now, I don't know how the price increases were divided up worldwide, but these are pretty substantial price changes. They have those [changes] built right into June--this was before last Friday--so

there's a big move in some of these factors. And their earnings are unbelievable.

While building has phased down and the automobile industry is staying a bit soft, [businesses] in our area are reporting unbelievable orders and profits expectations. Our railroad people are reporting really quite good operating results, much better than they had projected. And this is across the line, [even] with the downward push occurring in their automobile business. Our banks are showing a mixed picture. Many of them are pretty well loaned up and are not seeing too much demand because of rates in agriculture and some other areas. On the other hand, they are not seeing any problem with respect to delinquencies or slow pays or any of the normal [signs] one sees on that score. We had, of course, in the last couple of weeks this tremendous drive to increase commitments. Their customers were told that lines of credit wouldn't be honored and they had to convert those into revolving notes. So there was a tremendous scramble to offset the anticipated [government credit] control system by such things as price increases and wage increases and also by an explosion, really, in lines of credit. They were taking to their boards demands for loans that were 5 to 6 times their normally weekly increase.

We really don't know what the outlook is because we don't know how people will adjust; it's a crude guess that we're making. In view of your statement yesterday and other concerns, I am very concerned about the [potential] April bulge, which could be much larger than is shown here. And unless we react to that, our own credibility is going to be questioned even though [we expect the bulge to unwind]. We can't say "Oh well, it's going to go down in May and June, so we'll get back on target." I have a feeling that we have to respond to current developments. While the targets of "B" seem to me appropriate, in order to make those targets I'd like to raise that funds rate range by 2 points, let's say, to 13-1/2 to 20 percent, to give the Desk [the flexibility to respond], if necessary, if we get this kind of bulge. I don't want to raise it just to raise it. But unless we respond to the increase, which could be quite large in this period, we're going to have a real credibility problem.

I am impressed with those who watch the Desk. They will tell you exactly what the intervention points were; they don't see any change in terms of our intervention points which [they say are apparent] to the market. People, in spite of all the changes, are reading [our operations] as if we were operating under the old guidelines. While their perceptions are wrong, they still are perceptions; and we're dealing with perceptions as people interpret what we're doing and how they will react.

MR. PARTEE. We're certainly not dealing in eighths anymore.

MR. WINN. I know, but it's amazing to me that they can tell you what hour we intervened and at what rate. That hasn't changed. But I am really concerned about this April bulge and how it will be interpreted.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLEES. At times like this, Mr. Chairman, regional differences do show up rather starkly. West of the Rockies there are

precious few signs of any present or impending recession, particularly as our directors view [the situation]. With the obvious exception of housing and autos, things seem to be moving along at a very rapid rate. There is continued strength in consumer spending; it's almost hard to believe. I believe much of that still reflects a "buy it now before it gets more expensive" approach. Labor demand in defense-related industries and high technology industries such as electronics and aerospace is contributing to continued strength in employment in the District. Loan demand remains strong at banks and, despite the recent flooding in California, agriculture all around the West seems to be in pretty good shape. I think the difference between West of the Rockies and what Mark was reporting probably stems from the predominance of large branch systems around the West. I know that in California our three largest banks are among the three largest agricultural lenders anywhere in the country. And, of course, a good part of that lending is to agri-business, but they take reasonably good care of the smaller farmers as well--to the extent that we have some of those around the West, and we do. Demand for lumber you'd think would be falling out of bed because of housing, and yet exports to the Pacific Basin area have made up a good part of that. So, in short, while this may not be applicable to the national scene, our directors just don't see any signs of recession in our part of the country nor do they believe one is ahead for the regional economy. With regard to the national scene, it's obviously a different picture.

CHAIRMAN VOLCKER. Your area covers a not insignificant part of the national scene.

MR. BALLE. True. Well, with regard to the Bluebook alternatives, I can't really add much to what has already been said. All things considered, I would agree with much of what Willis Winn mentioned: One more month like February and our credibility is going to be in bad shape. We recently had the first of the ABA/FRB seminars, which originally was supposed to cover the subject of regulation under that plan that you encouraged us to get into. We had, I thought, a very good meeting. We had a number of people from the Board as principal speakers, some of the division directors and also Governor Wallich as a principal speaker on monetary policy. We got quite a bit of flak as I remember, Henry. There was quite a bit of skepticism expressed in that audience about whether we were going to stick to our announced target of ongoing restraint because of what those February numbers were showing--and they were aware of them by then--on the money supply. Another month like that would really undermine our credibility a great deal, so I share Willis' view about doing something about the April bulge if we can. And I think we probably should. In general, however, I would go along with the specs in alternative B.

CHAIRMAN VOLCKER. I think we ought to have a coffee break now, but let's make it short.

[Coffee break]

MR. EASTBURN. I have to address myself to conditions before last Friday. At that time businessmen in our area were generally feeling pretty good about current business, but I suspect that's changing. My own guess is that we are going to have a recession of at least the magnitude of the Greenbook projections and perhaps deeper.

In view of that, my inclination was to go with alternative B. But having listened to Steve about the April bulge, I do have a concern about that, which tilts me toward "C." Perhaps there is some way of going with "B" and watching closely to see what happens and moving later on in the period or of striking a halfway point between "B" and "C." That's about where I would come out at the present time.

MS. TEETERS. Do we have the technical capability of offsetting that refund?

MR. AXILROD. Well, there is some funds rate that would do it. But I would quickly mention that there is no certainty that [the projected] bulge is going to appear. We took 5 percentage points out of the seasonal factor this year relative to last year; and cumulatively that seasonal factor has been adjusted over the past two or three years to take 15 percentage points at an annual rate out of April growth. So, it's not absolutely certain that the bulge is going to appear.

MR. EASTBURN. I am interpreting this as the best estimate on the part of reasonable people of what's going to happen.

MR. AXILROD. Exactly. I just want to be covered both ways.

MR. PARTEE. If you look at page 7 [of the Bluebook], Dave, which shows the monthly profile: In alternative B, for example, April has a growth rate of 8.6 percent for M-1A and May has two dashes, which I assume means 0, and June has 2.8 percent growth. Something could be taken out of April and put it into May as far as the path is concerned.

MR. EASTBURN. Yes. I am sure that is true. And in ordinary conditions, I wouldn't care. We could certainly tolerate these numbers. But the point, which has already been made, is that the credibility of the System in that short period of time--

MR. PARTEE. My point was simply that we wouldn't necessarily have to move to alternative C; we could change the profile of alternative B.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. The agricultural sector has been reasonably well covered in the comments made by Mark Willes and Bob Mayo. Our banks supplying credit to the agricultural sector are very tight with respect to loan/deposit ratios. But contrary to what Mark suggested, we have found that the country banks are facing up to their problem and raising their interest rates to agricultural borrowers. They have no outlet for the loans even at these higher rates, however, because the correspondent banks are not prepared to pick them up, even at a discount, at the rates the credit is being extended. [Cattlemen] are withdrawing from filling the feedlots again as they turn their present stock, which implies less meat in the future I suppose. Secondly, as we go into the planting season, a period of high agricultural [loan] demand, there is a bit of a safety valve, if you will. There is still a lot of grain in the hands of the producers, which can be sold at the lower prices now prevailing. That would suggest that there will be a considerable

squeeze on farm profits in the period ahead. But I don't think the restraint program will have a great impact on the agricultural sector immediately. The grain embargo probably will have as great an impact as the restraint program. What I am really trying to say is that there are tough times ahead in the agricultural sector.

Turning to policy, Dave Eastburn captured my concern very well. In the Bluebook we are looking at a 4-month period instead of the usual 2-month period or even a quarter. It seems to me that credibility of the Federal Reserve System may be the more important aspect, at least of near-term policy. The potential bulge in April is part of the problem. I'd hate to go back to the [procedures used] prior to October 6 and focus on interest rates. But I think it's extremely important--for international and domestic reasons, inflationary anticipation, and other things--that we not permit [the funds] rate to come down very far in the next month or two. As a result, "B" looks very reasonable to me. I would be inclined to move a little closer to "C" because of the potential for interest rate movements if indeed the demand for money begins to ease somewhat because of the lower projection of growth. And as I understand it, the restraint program may depress that another half percent over the year. How that will roll into the [next] two months, I don't know. So, "B" would be reasonable and I would be inclined to move a little toward "C" if that were the sense of the Committee. I would also set the federal funds range by raising the lower end and reestablishing the 4 percent spread, thus coming out with a 14 to 18 percent range with the anticipation that interest rates would remain in the upper half of that range for at least the next 60 days.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. Well, [Mr. Guffey and I] are both from Missouri, and my approach to [policy] will underscore the great diversity of thinking that occurs in the great state of Missouri, Mr. Chairman. Very briefly, the general condition of the economy as we see it is a fairly level one with the exception of the building and real estate areas and automobile sales and manufacturing, which are obviously quite weak. Just last week we had a group of savings and loan people in for lunch, and they reported very severe trouble, as your savings bank people are experiencing, Frank. Our agricultural loan demand continues strong. Basically, we haven't sensed any significant weakening in the last few weeks.

With regard to policy, I would favor alternative B. I would resist like the plague any narrowing of the fed funds range. If anything, I would favor a widening of it; I certainly wouldn't seek that, but I would oppose a narrowing of it. With regard to this matter of credibility, I wonder if it isn't incumbent upon all of us to go out of our way in the weeks and months ahead to explain what we are trying to do and have our staffs at their various speaking [engagements] concentrate on explaining it, too. I think there is a general lack of knowledge. Within this room there is the capability of telling people: Don't look at the weekly figures; don't even look at the monthly figures. I don't think we have to be slaves to this problem of credibility. We should be missionaries and salespeople to the greatest extent possible and explain how we are trying to operate now. Anyway, that's the gist of my point of view.



CHAIRMAN VOLCKER. Mr. Mayo.

MR. MAYO. Mr. Chairman, I would only add on the agricultural side that I think some of the trauma accompanying the announcement of the grain embargo has subsided. There is a much calmer approach to the problem and a little more Federal government credibility than [earlier] in the farm community, although they are still somewhat skeptical. We are, of course, in a very poor position on autos and housing throughout our District. But capital goods are still running quite strong. This is typical of what one might call "this stage of the cycle." I feel more comfortable than I did last month with the Greenbook [forecast], yet I would not be surprised if we got down to a minus 5 percent quarter [for GNP] before this forthcoming recession is over. I think we are getting closer, much closer, to the peaks that we keep visualizing and postponing, and we could easily have a credit crunch--though I don't know how best to define that--perhaps in the next 4 to 6 weeks.

Having said that, I would be happy enough with "B," but I would tilt also a little toward "C," agreeing with what Dave had to say. On the federal funds range, though, I would just leave the [lower limit of] 11-1/2 percent. It has no real significance now and I wouldn't want to see us push that up at this point. It restricts our image of flexibility when it gets published. Instead, I would just go to the 20 percent on the up side and be done with it, recognizing that that would give us cover for an interim period, rather than have to go back frequently to jiggle it up another half or one percentage point. I don't see any objection to going to the 20 percent, given the rate structure we have today.

CHAIRMAN VOLCKER. Mr. Rice.

MR. RICE. Well, Mr. Chairman, generally I go along with the staff forecast. It seems to me that the new anti-inflationary program will have the effect of making the coming recession deeper than it might have been and might even bring it on sooner. If I have any skepticism at all [about the Greenbook forecast], it's in the area of the timing of the recession. The economy appears to be continuing strong, or relatively so. If I read the Redbook correctly, most of the businessmen around the country report remarkable equanimity in the face of the economic situation; they just don't seem to be excessively concerned about--or, in any case, feel confident that they can deal with--whatever is down the road. It's pretty difficult to find evidence of weakness in the economy aside from housing and autos; one has to look pretty hard. One has to look behind the industrial production figures to see that there would have been a decline in industrial production had production of autos and parts not risen. Also one has to note that capacity utilization in the primary processing industries and materials-producing industries has declined. And, of course, the average workweek has declined somewhat. These are about the only signs I see of any emerging weakness.

So, I feel that our posture at the present time is about right, with the appropriate tautness in financial markets. I don't think alternatives B and C leave us much to choose between. Actually, [for M1] the difference between them amounts to about \$900 million at the end of June, and that doesn't strike me as being very much money out of the total money supply. So, it doesn't really matter too much

to me whether we choose alternative B or C. If we choose alternative B, it appears that we will have a slightly larger volume of money starting in April and a less substantial rate of increase in the third and fourth quarters. On the other hand, if we choose alternative C, we will have a lower rate of increase in the second quarter and a higher rate of increase in the third and fourth quarters. Given the current situation, it would seem to me better on balance to lean harder in the second quarter and increase the restraint then; that will [show through] in the third quarter and allow for a slightly higher rate of increase in those quarters when we expect the recession to hit. Alternative C would probably be more consistent with that scenario than alternative B, but I have to repeat that really it doesn't make a great deal of difference. On the funds rate, for now I would favor a ceiling of about 18 percent, but I am prepared to raise the ceiling if market conditions [warrant].

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. It's very difficult to tell what effects our policies are having. These high interest rates may hit some borrowers very hard but they don't seem to hit others at all, and the net effect one can't predict. I see that Charlie Schultz, after the President's program was announced, predicted a 2-1/2 percent rise in GNP for 1981, so he doesn't seem to think that this has a very powerful impact. I am particularly concerned about the inflation forecast. I view the forecasts of both our staff and the Administration as wildly optimistic. The very slight recession that we are anticipating is very unlikely to make that kind of dent in the inflation rate. Of course, we have a history of always underestimating the rate of inflation.

I am aware of the repercussions of a firm policy at savings banks, small commercial banks, and elsewhere. As these [problems] come toward us, we have to be prepared to meet them, and I think we should meet them in a liberal way--stretch our powers as far as they can reasonably be stretched. But we should not be obsessed by the concern that the recession may last a little longer or even be a little deeper. As I look back over our record, I am impressed that we never stopped fighting recession. We moved imperceptibly from fighting the last recession and its consequences into worrying about the next recession. And that recession concern essentially has dominated our thinking and has brought us now to 15 percent inflation. It's a situation with very poor options, but I lean toward the firmer ones. That is, I lean toward "C." The market has not been impressed by our policy package except abroad. The bond market hasn't responded very much. Short-term rates are actually down. I think there is a real danger that if we now give the impression that we are about to relax our general credit restraint behind a shield of selective credit controls, we will get the worst of both worlds. We'll get the selective controls not working--I have not been very enthusiastic about them anyway--but we should do what we can not to disavow them completely. That is best done by not throwing any burden on them and by holding to a firm general control. I think it's important at this time not to convey the impression that the regular discount rate, which wasn't changed, is the discount rate and that essentially we have taken evasive action in trying to avoid raising the discount rate. We should so operate on nonborrowed reserves that there is a

good amount of borrowing at the surcharge so that the rate acquires some credibility.

Finally, I share the concern about the April bulge. If we have taken 15 percent out through the seasonal adjustment, there must be a lot of money out there--in reality, people don't draw checks on seasonally adjusted checking accounts--and that may have its effect. So in addition to "C" generally, I would like to see a funds range of 14 to 20 percent. Thank you, Mr. Chairman.

CHAIRMAN VOLCKER. Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, it seems to me that our posture of restraint had begun to bite before this past weekend. [If it was] biting before this past weekend, presumably it will bite a little more now. I have to admit I've held such views on several earlier occasions, so I don't know how much weight to put on my current view. We did hear reports last week, however, of several real estate developers being cut off by large banks in our District. Our recent survey of the agricultural credit situation does not reveal the tightness that has been reported elsewhere in the country. And I do have the impression that our farmers are among those who are carrying excessive inventories at the present time, largely in the interest of deferring income tax liabilities.

I don't know to what extent the Greenbook projections assume that the capacity of people to adjust to an inflationary environment is behind us or to what extent it might still be ahead us. In my area I see indications of a good deal of capacity to adjust further. Some of this, of course, flows from the firm linkage that seems to have developed between that area and foreign sources of funds for investment. Just to indicate the extreme to which this seems to be going: I am told that at the present time builders in our major centers who complete expensive houses which they don't sell promptly to local purchasers sell them to foreign buyers who then furnish them and rent them out. And this is a means of investing funds at obviously very low rates of return currently for the purpose of getting into real estate, in this instance in fairly modest-size packages. There are a lot of small business firms being sold to foreigners as well, all the way from the family-size motel to the family-size manufacturing firm. That seems to be going on yet at a rapid pace. I note that the oil drillers have been in Washington recently; they have about as much reason for being here at the present time as the farmers had a year ago and two years ago. The number of active rigs is at a 23-year high; the increase during the past month was almost spectacular and the increase over the past year was also very strong.

So, the signals are mixed. As I say, it seems that credit is biting but activity is still very strong and the outlook is strong. I think there's also a good deal of capacity yet on the part of individuals to adjust the management of their financial situation to continued expectations of inflation. Possibly one indication of this is the alacrity with which they are willing to give up accumulated interest on CDs for the purpose of turning them in and getting a new one which will carry a higher yield. This has resulted in actual lines of people at banks in some recent weeks when the new rate announced was significantly higher than the rates on outstanding CDs.

As to monetary policy, the "C" proposal seems preferable today, primarily for the reasons that Steve Axilrod outlined in his oral remarks. Others have commented along that line. That's all I have to say.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. Mr. Chairman, I am in favor of alternative "B." Even [with "B"] the rate of growth [for M-1A] in the period from April to June would be dropping to almost half of what it was in the first two months of the year; even compared with the first three months, it's very low. If we go to alternative "C," we're going to be cutting growth relative to the first three months in half, and that implies to me a very stringent credit market. If people think they've had stringency these [past several] months, it's only going to get worse if we go to the more stringent specifications. I will be very brief: I support alternative "B" as it now stands with the 11-1/2 to 18 percent range on the federal funds rate.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I don't know what's going to happen to the economy. Perhaps I am associating with people who are in difficult situations and have become very pessimistic, and it may be affecting me. So, I may be more pessimistic than I ought to be. I would point out that the projection seems to me very, very sensitive to the saving rate. The projection shows no increase in the saving rate in the second quarter and, therefore, the second quarter continues to be not a bad quarter. If in fact the saving rate should increase in the second quarter, it would be a bad quarter for the economy. And that could happen. On the other hand, the projection has sizable increases in the saving rate in the third and fourth quarters, and those are the quarters of major recessionary movement. Whether those increases occur or don't occur will affect the character of that pattern. So, we still have the uncertainty that has been with us for some time, and that is: What is motivating people and how might [their behavior] be changing?

I do feel that everything that has happened in the last month has increased liquidity preference. The rise in rates, which was very sharp and very noticeable, and the cutting off of credit cards to certain low income groups, even before the President's program, have been played up in a major way in the local press here in Washington. The feeling that one might need to rely on one's resources more and on other people's resources less in the period ahead leads to an increase in liquidity preference, which would tend to give us rather larger money numbers, generally speaking, relative to GNP than was the case before. I also think that the relationship between M1, or narrow cash balances, and the real economy is changing adversely. That is, it takes more and more M1 in order to get a particular real income; or we get less and less real outcome for the same M1 we had before because of [higher] cash balances, to the extent that people are buying more with cash and not using gasoline credit cards and so forth. The credit lines that have been extended, many of which may call for compensating balances, and the fact that we are forecasting more and more inflation, mean either that a given M1 is going to carry with it a higher interest rate or lower real activity, or both. And I think both is probably the case.

So it seems to me that it's just the wrong time to be departing from the notion of a rather normative, reasonable increase in the monetary aggregates. I would very much resist moving to a lower aggregate path like alternative C. If we get the recession, Emmett, which I believe we will, I think we'll find that the demand for money in the second half of the year will be low enough so that our problem won't be so much the upper end of our range but keeping growth within the lower end of our range.

That brings me to one more point, which is that I would hate to have somebody ask me what I was doing during the crash and have to remark that I was defending our credibility. The people who say let's keep those interest rates up there, regardless of what happens, are really walking into a major trap for the economy and for the Federal Reserve. I very much want to disassociate myself from that. I would go with alternative B. I would adjust that path and slice a little off April and put it into May. I think that has the same effect, if there is a bulge in April, as going with alternative C. I am sympathetic to the idea that we need more room in the funds rate range because there is a very good chance of a big bulge, and the Manager ought to be able to move if there is a bulge. If there is no bulge, I wouldn't expect him to move. Therefore, I rather like the idea of a 14 to 20 percent range on the funds rate which, with the rate now at about 16-1/2 to 17 percent, means we have some room on both the up side and the down side.

MR. RICE. Could I just ask a question? Isn't it true, if we stick to the 4-3/4 percent annual rate of growth under alternative B, that we are going to have to reduce the rate of growth later in the year?

CHAIRMAN VOLCKER. Yes.

MR. PARTEE. A little, but that will be easy to do because there is a much lesser demand for money in a recession.

CHAIRMAN VOLCKER. Assuming we have a recession.

MR. PARTEE. That's all this is really saying--how far one is going to let interest rates decline in the second half of the year.

MR. RICE. But we are setting the timing of the recession rather precisely, it seems to me. And I am not too sure that we're going to get it starting in the second quarter.

MR. PARTEE. Well, your suggestion will certainly help assure that we'll get it because if we cut the path in the immediate period to come, I would guess we're talking about 25 percent interest rates. And I think that--

MR. RICE. Well, we're really just talking about a few hundred million dollars [of added M1 growth].

MR. PARTEE. That's all right; it's a very hard thing to bring about. It involves more in M2 and M3.

MR. RICE. You're absolutely right.

MR. PARTEE. It's quite a lot on the margin.

CHAIRMAN VOLCKER. Governor Schultz.

MR. SCHULTZ. I doubt that we can get out of this situation without a recession, and I think the unkindest thing we can do is to drag this on. It seems to me that the greatest pain can come if we let it go on and on and our financial institutions really do begin to go under. Small businesses and others can stand a lot of pain for short periods of time but if this keeps dragging on, they will be in deep trouble. I would worry very much about a big bulge in April. I am not strongly influenced by alternative B or C; somewhere in that area would suit me fine. I would like to see the upper end of the federal funds range raised to 20 percent. My feeling is that we ought to be very resistant to a big bulge in April.

CHAIRMAN VOLCKER. Let me make a few observations that occurred to me in listening to all this. First of all, it's clear that the economy is fairly level, so any month we look at these figures we're going to find some things down and some things up. What that means for the future isn't very clear. There's considerable strength and resiliency over broad areas of the economy or it wouldn't be holding level or a bit on the up side in the face of a decline in housing and a decline in autos and some other industries. What stands out to me is that we haven't any room to grow here, given the declines in productivity and other pressures on the economy. And if we tried to stimulate growth very much, we really would have no chance of dealing with the inflationary psychology; we'd in fact face a blow-off on the inflation side if we don't already have a blow-off.

Secondly, in my opinion--and everybody can be his own psychologist--at this point we don't have many believers in the view that inflation is about to ease off or, indeed, that the economy is about to fall out of bed. There is more nervousness than there used to be and some people are beginning to question whether they shouldn't change their views. It was characterized for me in talking to some farmers from Iowa the other day, and I think their attitudes are probably similar to [those held by people in] other sectors of the economy. A couple of them sitting near me said that they had bought some land last year at prices they considered exorbitant but they bought it confidently with the thought that prices would be even more exorbitant this year. And they are wondering whether they made a good buy. In fact, they're beginning to wonder whether they could sell it or should sell it, but they haven't seen any evidence of a decline in land prices up until now. They were getting worried but they hadn't seen anything. I suspect that a lot of industrialists are thinking the same thing in their own way. The fiscal policy program--and I think it has been underestimated a bit in the public press for a variety of reasons, political and otherwise--I certainly don't think was strong enough to change these attitudes in any significant way. It may be to the contrary in the feeling that if anything is going to be done, it's going to be done through the credit policy side.

So far as the outlook is concerned, it seems murky to me. I hear all these fears of recession and I even share them. But if you ask me analytically whether they are any more certain now than they were a year ago when we began hearing the same things, I don't know. I am pretty well convinced that it's going to start some time and that

there's a risk, when it starts, that it may be greater than anybody is projecting. But I thought that a year ago, too. Just when it will really start, who knows? I know we--all of us, I think--have misjudged the timing again and again. I share the thoughts that some people have expressed, most recently Governor Schultz, that we better get this over with in terms of minimizing the total pain over a period of time. I am worried about those financial institutions, and the worst thing that can happen to them is [for us to] fail to do the job and get the interest rate turn fairly soon. But the way to get the interest rate turned is not by hastening it prematurely. If we have another false start, we'll be in considerable trouble even though that clearly runs the risk of overkill. That risk is greater in its inverse logic than if it's not killed at all; we'll be faced with the same dilemma later on.

In that connection, in getting out of our dilemma as best we can, I put considerable emphasis on one aspect of the voluntary program, which is to get banks to begin saying "no" on some loans and not to put all the pressure on raising the prime rate. If the loan demands come home to roost [and they take the latter approach], it will exert pressures throughout the money market as they go out and try to finance the loan increase. If we accomplish nothing else in the next few weeks--and I think the time is very short--if we can get that message to the banks and they can get the message to their customers, we have some chance of at least moderating the short-run interest rate pressures. I don't think we have a chance of dissipating them but we do of moderating them and getting some element of rationing in the area of the market where it does not now exist, namely among the bigger business borrowers. I would urge you to move promptly on that voluntary program and get the questionnaires out and to begin on occasion, or maybe more than on occasion, a consultative process with the banks, particularly the biggest banks in your area very promptly.

We have the April problem that has been referred to, and all of these things incline me toward resolving doubts in the direction of greater tightness in the very short run rather than the opposite. The worst thing we could do is to indicate some backing off at this point when we have an announced anti-inflation program. We have political support and understanding for what we have been doing. People don't expect it to be too easy. There is an understanding that a lot of burden has been placed on credit policy, and there's a willingness to be supportive for the moment in that connection. I would not give all that much weight to the degree of support we're going to get if this is dragged out indefinitely and we have to go through this process once again.

Where that leaves me in terms of "B" and "C"--I don't think anybody mentioned "A"--is that at this particular juncture I find the focus a little long, frankly, for me to come to any great conviction between "B" and "C." I share much of Governor Rice's feelings about those alternatives. I do attach some significance to the fact that if we took "B" literally, while the numbers as presented on page 6 of the Bluebook look low, [they imply] running above our annual targets in the way we calculate those targets. If we were going to be at the midpoint of the annual target, it would require a considerable decline in the second half of the year from the 5-1/4 percent quarterly growth

pattern implied by "B;" and even "C" is above the midpoint of the annual target for M-1A. You are shaking your head "no."

MS. TEETERS. "C" would mean 4-1/4 percent per quarter for the rest of the year.

CHAIRMAN VOLCKER. "C" is 5 percent for the first two quarters, as I have calculated it, and the midpoint [of our annual target] is 4-3/4 percent. It comes close to the midpoint but is a little above.

MR. PARTEE. Yes, because February is behind us.

CHAIRMAN VOLCKER. Oh, there's no question that we have recorded a high number for February, which has contributed to that result. But we have recorded it. But again, I [wouldn't] worry too much about where this comes out within a range of 1/4 or 1/2 or even 3/4 percentage point on a February-to-June number, since all of those differences are within our normal range of error anyway. That doesn't excite me terribly at this point. Other people may have different shadings but whether we're looking at "B" or "C" or something in between in the four-month time perspective, I believe it catches the spirit of what a number of people are saying anyway, to say that in the next month or so--certainly before we next meet--we should be leaning toward taking our chances on being certain to be near those numbers in that very short-run period. I am not saying we can guarantee that we will be within those ranges at any expense of interest rates or anything else. But when we're making up the paths and deciding what the level of borrowing should be or whatever, we ought to be resolving doubts and making sure March is as low as projected and April is no greater than projected or that both of them are lower than projected because that's where our principal vulnerability lies--in this two-month period. If April is anywhere near as strong as the New York figures suggest, we'll be above the "B" alternative. I feel quite certain that we at least ought to be leaning in the other direction, and reasonably hard, during these next six weeks or so. We don't want to give the market a false signal if the money supply comes in very low for a couple of weeks that we are relaxing too quickly during this immediate time frame, when we've just announced these new programs and there is the kind of feeling in the country that I think exists. There is plenty of time before June to take account of any shortfalls we might have in the money supply if that happy event should occur in the very immediate future. I don't know what the March data are going to show. If March came in under Mr. Axilrod's projections and we were facing--in terms of our seat-of-the-pants judgment or the pit of our stomach or whatever--the kind of bulge that is projected for April, we ought to be delighted with a low March figure. So, I am suggesting that we lean in that direction. And whether we come out between "B" and "C" over a four-month perspective concerns me less than [that we take] this posture I have suggested before the next meeting. We could reconcile my longer-term concerns by making it someplace between "B" and "C" but in the end I could probably tolerate either. But I do feel rather strongly about not giving any false signals in the very short run at the risk of any overkill that might be implied by that.

MS. TEETERS. Would you consider taking a shorter period of time--in other words, setting a target for March through May?



CHAIRMAN VOLCKER. I could, but it's probably going to take a lot of arithmetic here. As I say, we're going to be meeting again in a month and we can fine-tune the quarter further then. So that really concerns me less than an understanding about what our posture should be in the next month and how we will reconcile all the doubts and errors and fluctuations in figures that we're going to have during that time period. Whether it's expressed as aiming at "C" or being extremely resistant to anything above "B" doesn't concern me so much because I don't think those differences are great. I would put money in the bank if that happy day arose at the end of March or early April and the bulge that is being projected did not appear in that extreme form.

MR. WILLES. What would you do to the funds range?

CHAIRMAN VOLCKER. Well, I don't feel terribly strongly about that because we obviously have a very flexible technique for changing that range if the occasion arises. But in the spirit of what I am saying, if the Committee wanted to raise it--particularly the upper end--such a decision would reflect the attitude I am talking about. I don't know whether we'd have to use [the full range] or not, and there's no implication that we'd go out and use it because it's there. I don't have any particular expectations that the rate would have to [reach that upper limit] or that [raising the limit] carries any connotation at all that we will aim at it. I do think that we should resolve the doubts on the borrowing number by putting it a little higher rather than a little lower. And in that connection, I am not quite sure where we are specifically. I have lost track of this recently. I know borrowings are running over \$3 billion on an average basis, but you were talking about a \$2-1/2 billion figure as--

MR. AXILROD. We have suggested a borrowing assumption of \$2-1/2 billion on "B" and about \$2-3/4 billion under "C."

CHAIRMAN VOLCKER. I don't know what the right number is, but assuming you judged those two correctly, I would be inclined to use the higher number. I am talking about the very short run for the staff's initial planning. Now, if the money supply came in lower, you would reduce it.

MR. AXILROD. The higher number would be more consistent with the behavior of borrowing in the last two weeks. We're having a hard time interpreting whether demand or technical problems--

CHAIRMAN VOLCKER. I think the market is confused at the moment, understandably, about what all these recent actions mean. One interpretation is that we would deliberately try to ease pressures on the money market. [Market participants] are looking for the substitute in this voluntary program. There's another interpretation that says that's not true. The former interpretation would not be helpful at this particular point in time, although in a general sense what we're aiming at is partly to avoid the extremes, perhaps, of a further jack up [in interest rates]. That's a little different from saying we're aiming to ease from where we are or [unintelligible] of easing from where we are. But I have a concern that if things went the wrong way and if people were not over this psychological hump about inflation--which I don't think they are, although we may be beginning to shake people a little--and they relapsed and thought we

were easing, that would involve the greatest chance that we'd get a continued big loan demand, which would drive up the prime rate and give us higher rates. I think we're in a perverse situation here. If those commitments are ever drawn upon, the banks are going to be panicky and they're going to be putting their rates way up to protect themselves.

So you can have something concrete to shoot at--and let me just say again that the least of my concerns is precisely whether it's "B" or "C" over a full four-month period--and to capture slightly the flavor of what I am saying, let me suggest the following: For M-1A, use 2-3/4 percent for the February-to-June number; put the funds range at 14 to 20 percent, say, which again is no goal to shoot at obviously in either direction, but I'm trying to pick up the flavor of what has been said around the table; and aim at \$2.7 or \$2-3/4 billion or something like that in borrowings in the very short run. And for this immediate period, and I am talking about a few weeks here, let's reconcile doubts in the path-building--which are plenty, given the performance of borrowings recently--on the side of being happier about an undershoot of the present projections for March and April than an overshoot.

MR. PARTEE. Where are borrowings? Where were they last week, Steve?

MR. AXILROD. Around \$3.4 billion. And they're averaging \$3.1 billion thus far this week and were \$1.9 billion yesterday.

MR. PARTEE. With quite a lot of excess reserves out there?

MR. STERNLIGHT. It's worth keeping in mind that one reason borrowing has been high was the anticipation of something happening in the discount rate. Something did happen and there's a much greater uncertainty factor than usual, given the whole surcharge situation now. I think there is more need for flexibility in whatever understanding the Committee reaches on that borrowing level.

MR. WALLICH. If borrowings were, let's say, in the \$2-1/2 to \$3 billion range, what part do you think would be at the 13 percent rate and what part at 16 percent?

MR. AXILROD. I don't know. But I actually went back to [estimate what that breakdown would have been in] the fourth quarter of '79. And if actual borrowing [and its distribution] hadn't changed because of the surcharge--it would have, but if it hadn't--it turns out that of the average daily borrowing of \$1.8 billion in that quarter, \$1.2 billion would have been at the surcharge. So, about 2/3 of it would have been at the surcharge rate. But what it actually will be over the next four weeks, I really have no idea. It has been a little higher than I would have suspected. If these banks try to avoid [paying the high rate] by not borrowing and we put in a target of \$2-1/2 or \$2-3/4 billion, that ought to put upward pressure on the funds rate.

CHAIRMAN VOLCKER. I missed a little of this. Any of the borrowing figures we're talking about now are below the recent level, which raises a little question, I guess.

MR. MORRIS. I think that's appropriate, Paul. My guess is that the big banks will back away from the window and try to preserve their flexibility.

CHAIRMAN VOLCKER. Well, we just don't know. I think that's possible. But it's implicit in this that we start at what is a lower level of borrowing than we have had just recently. And if the money supply figures were coming in a little high relative to the projections we now have, we might raise [the borrowing level] a bit. I guess that's the implication of what we're saying.

MR. AXILROD. I was assuming, Mr. Chairman, that one of the implications was that the Committee didn't want to be as accommodative in April as we had in [the Bluebook] and that for whatever path the Committee decides we might lower both March and April and shift a little of that into May and June.

MS. TEETERS. Mr. Chairman, I object strongly to raising the floor on the funds range. I have a feeling that when we hit the recession we're going to hit it very suddenly and that we may very well get into a credit crunch. It seems to me that it would be wise to keep the wide band and as [much] flexibility as possible. It also goes with my long-range feeling that we do want to have a very wide range on the federal funds rate and let the market determine the rates over time. We have broadened the federal funds range, and I think that was a move in the right direction. I don't mind going to [a ceiling of] 20 percent, but I don't particularly want to raise the floor.

CHAIRMAN VOLCKER. I find it very difficult to conceive that we're going to get to the lower end of the range before the next meeting anyway. This is probably the least important number we put down. And from that [perspective], it doesn't bother me.

MS. TEETERS. I agree with that, but the idea of keeping the range wide in case we do get into a crisis situation appeals to me.

MR. PARTEE. It does seem to me, though, Nancy, [given that] we have raised the discount rate since the last meeting, that to accept that floor, which is slightly below the 12 percent discount rate [unintelligible]. Operationally, one has to figure that banks would first pay off the borrowings before the [funds rate] went lower. So, logically, there is a basis for a one point increase.

MS. TEETERS. I still think the wider the range, the better, because we really don't know what we will be getting into in the next two or three months. And the possibility of a credit crunch is out there; it's not an impossibility at all.

MR. PARTEE. It's quite probable.

MR. WALLICH. That would press the upper end, not the lower.

MS. TEETERS. It depends on what happens afterwards, Henry.

CHAIRMAN VOLCKER. I think we're talking about the visuals of what is announced a month from now and I can't convince myself that this is an absolutely crucial decision. One could argue that raising

the funds range is consistent and reinforces the notion that we're not backing off. On the other hand, if we don't change it, it can be interpreted as an indefinite widening of the range.

Well, we have a small mechanical problem. It is small in one sense; I don't know that it affects anything. The staff has written the directive tentatively to include a growth range for the whole first half of the year, which makes it even less sensitive to what we're talking about in the next month or two. I don't know whether that's a good way to word it or not. The only problem with wording it for the second quarter--and we can all convert this into a second-quarter growth rate--is that we don't know exactly what the [first-quarter] base is at this point. The equivalent of what I suggested, which is 2-3/4 percent for 4 months, would be about 4-3/8 percent for the first half. And that begins to look a little too fine. We could say 4-1/4 percent. The last published target we had was 4-1/2 percent for the first quarter, which I take it we will exceed.

MR. PARTEE. Make it 4-1/2 percent for the half-year then.

CHAIRMAN VOLCKER. We can put in 4-1/2 percent for the half-year, which is right on "B." It doesn't capture the flavor that I thought [we might want to convey] of putting it a little below that. But in very round numbers, it's not very different. When we get down to the point of how to express it within a 1/4 of a point, it's difficult. The 4-1/2 percent certainly implies no change. It implies a lower growth rate in the second quarter than in the first, given what we know at the moment. It's a little easier than I suggested, but I suppose we could take care of that by some language which says that at least for the moment--I am talking about the period to the next meeting--we want to be sure not to exceed [that growth rate].

MR. AXILROD. I think in October or sometime the language--not the number--was something like "4-1/2 percent or a little less."

CHAIRMAN VOLCKER. Yes, maybe we can use that language. I think it captures what I am trying to say, maybe better than I said it. Well, let me review the bidding here. Suppose we put the directive the way it is written [in the Bluebook] and talk about the entire half-year [target as] 4-1/2 percent or a little less. For the funds rate range, we would move the upper end to 20 percent. On the lower end there's obviously a difference of opinion, which is going to be resolved. And in terms of the projections given to us, we will lean to being within those projections for the March-April period in setting the nonborrowed path target, interpreted as \$2-3/4 billion of borrowings right now.

MR. WALLICH. That looks low to me.

MS. TEETERS. Which one? The borrowings, Henry?

CHAIRMAN VOLCKER. Based upon the very recent experience, it does look a little low.

MR. PARTEE. Well, the very recent experience, yesterday, was \$1.9 billion.

CHAIRMAN VOLCKER. I am not sure one day's borrowing is--

MR. PARTEE. Except that it was the first day after the surcharge.

MR. MORRIS. We just don't know how the big banks are going to react to this dual rate.

CHAIRMAN VOLCKER. I know we don't. I think we'd have to say that if we start off there and that level of borrowing appears--though it's never this clear--to be accompanied by a falling federal funds rate and an indication of higher money supply growth, we'd raise [the borrowing level].

MR. WALLICH. But there would be almost no borrowing at the higher rate.

MS. TEETERS. We don't know.

MR. PARTEE. I don't think we're capable of deciding this.

MR. TIMLEN. They will be borrowing at the higher rate when the funds rate is at 18 percent.

CHAIRMAN VOLCKER. What I am trying to get is some flavor. We have to make a decision as to where to put [the initial borrowing assumption]. I'd be perfectly happy to put it higher and resolve the doubt that way in the first round. In any event [the staff] needs to know what we're aiming for. I am saying that for the March-April figure together we'd be unhappy if [money growth] were not at that rate and we'd rather tolerate a shortfall. Having said that, there's no promise we're going to confine [money growth] to that rate.

MS. TEETERS. Then you can't really confine the borrowing.

CHAIRMAN VOLCKER. Well, I don't mean to confine it. All I am looking for is some assumption to go on. If you want to forget about that, we'll solve it otherwise on the understanding that we're aiming for 4-1/2 percent or a little less [M-1A growth] for the first half of the year. Now that brings us basically to "B" or less.

MR. TIMLEN. Do you want to define "little"?

MR. PARTEE. Well, less than, say, minus 1/2.

CHAIRMAN VOLCKER. We're not talking about minus tenths.

SPEAKER(?). Governor Partee, that's a reduction ad absurdum.

MR. PARTEE. No, but I don't think we want [money growth] to bomb in the next few months. And I can't accept more or less than--

CHAIRMAN VOLCKER. Well, nobody's talking about more or less being minus ten. We'll resolve these doubts on the side of less rather than more. And if that gets translated into the March-April number as projected, we'd be happy to come in lower than higher.

MR. AXILROD. Mr. Chairman, just to be clear: At the moment we're projecting 4.6 percent [as the average M-1A growth for March and April], and we'd target on that if nothing else were said. In light

of this discussion, I would propose that we tend to even it out [over the four-month period ahead]. That is, we'd target on something like 3 percent or a little higher in March-April which would mean May-June would be around 3 percent or thereabouts; the two periods would be roughly even. March would be low and April high, but pressed down relative to what we show now, depending on what the data we get tomorrow look like.

CHAIRMAN VOLCKER. I resist a little the precision that's implied that we can make it 2 percent less than an uncertain projection that--

MR. AXILROD. Oh, no; I was talking about what we'd target on, not what we'd achieve.

CHAIRMAN VOLCKER. Well, that's one way of putting it.

MR. SCHULTZ. If you did it that way, that would show real resistance to that April bulge, if it occurs.

MR. AXILROD. Yes. We would be targeting on [a smaller] bulge. If it started coming in even as high as we have projected, we'd begin resisting.

CHAIRMAN VOLCKER. I don't think we should kid ourselves, either. If the New York projections turned out to be right and there were enormous upward pressure [in April], I don't think we're saying we would raise the federal funds rate to 25 percent in order to get [money growth] down to the plus 6 percent [upper limit of our long-term range for M-1A].

MR. SCHULTZ. We're not saying that, are we?

CHAIRMAN VOLCKER. I don't think we're saying that. I just wanted to [clarify that].

MR. PARTEE. The funds rate would not go over 20 percent, at least not without a meeting. What happened to Richmond's projections? Is Richmond no longer in the projection business?

MR. BLACK. We began to have as many misses as the Board's staff, so--

MR. PARTEE. So you gave it up?

CHAIRMAN VOLCKER. I think it is correct to say, as of now anyway, that we're not going to resist the April bulge, whatever it is, beyond a federal funds rate of 20 percent.

MR. SCHULTZ. Unless we have a meeting.

CHAIRMAN VOLCKER. I don't know how to interpret the silence, but maybe we ought to have a vote.

MR. PARTEE. On what?

MR. TIMLEN. A little less than "B."

CHAIRMAN VOLCKER. The directive will be expressed as 4-1/2 percent for the first half of the year or "a little less," if you want that modifier in there. On the funds range, there's some uncertainty here, but I take it the upper end is 20 percent. And I don't know [about the lower end]. You don't want a change at all, Nancy.

MS. TEETERS. I'd like to keep it at 11-1/2 percent. I just think it's a good idea.

MR. SCHULTZ. I like the broader range, too. There's some slight--

MR. ROOS. I'd like to keep the 11-1/2.

CHAIRMAN VOLCKER. Let me just see what the consensus is. [One option is that] we don't move the lower end but put the upper end at 20 percent. And that would be all that appears in the directive for this discussion, right?

MR. ALTMANN. Right. [The range shown in the directive] would be 11-1/2 to 20 percent, if that's what you mean.

CHAIRMAN VOLCKER. I suppose the M-1B that is consistent would be 5 percent or a little less.

MS. TEETERS. Don't you think "somewhat less" is a little more dignified?

CHAIRMAN VOLCKER. "Somewhat less." Operationally we understand that. And there would be some language in the discussion to reflect--though I'd hardly put it in these terms--that we want to take particular care not to exceed that rate in the period immediately ahead. To remain within [the six-month target] is roughly the way to say it, I guess, as the March-April average would work out. We won't put the borrowing [assumption] in the directive, but you understand what the implications are for that. So, the precise specifications are only the first two numbers, but there will be discussion [in the policy record] about the importance, during the period immediately ahead, of resisting an increase in the money supply beyond this six-month target.

MR. AXILROD. I just want to be sure what that means, Mr. Chairman. The average March-April rate of growth between "B" and "C" is about 4-1/2 percent. I was not going to build a path on that but on a lower rate of growth and then shift some of it into the May-June period.

CHAIRMAN VOLCKER. What is the average?

MR. AXILROD. It's about 4-1/2 percent--between "B" and "C"--for March-April. Now, we only know 5 days in March for sure, so March in some sense is an unknown. What I think is consistent with the Committee's discussion--I want to be sure of this--is that rather than the 4-1/2 percent for March-April and about 1 percent for May-June [implied in the Bluebook], I should shift some of that growth into May-June. So you would be resisting at a lower rate of growth in March-April.

MS. TEETERS. How much lower?

CHAIRMAN VOLCKER. Well, I think we can take care of that in the discussion. I was just trying to avoid some wording that relied upon an internal projection.

MR. AXILROD. I understand. I just want to be sure that what we're planning to do is clear to the Committee.

MS. TEETERS. But how much lower in March and April?

MR. AXILROD. Well, I think we'd have to wait until we look at the numbers and Mr. Sternlight and I have a chance to chew it over. But one thought would be simply to make March-April 3 percent and May-June 3 percent in round terms and even it out. We generally tend to use an even [pattern] if we can. It doesn't seem likely that growth in March and April will be even, but maybe for the two months it wouldn't be unreasonable to target it that way. Then if March turned negative at minus 1 percent, say, April could be plus 7 percent. That would be an example. Or if March turned out to be plus 2 percent, then the April [path] would drop down to a plus 4 percent rate or something like that. It may not be that even; it will depend on what it looks like.

MR. TIMLEN. Mr. Chairman, in light of Mr. Pardee's comment that the only thing that is keeping the dollar strong in foreign exchange markets is the level of interest rates in this country, I have some difficulties in not moving up the floor [on the funds rate range], as a few people have suggested, to 14 percent. A 14 to 20 percent range at least is a 6 percentage point spread as compared with the 4-point range we started with. That 14 to 20 percent would be my preference.

CHAIRMAN VOLCKER. That seems to be the only element on which there may be some substantial disagreement. Do you want to vote on the other parts and leave that open or vote on the whole thing? Let's do it the other way around and see how many Committee members want to move to a 14 percent [lower limit] as proposed. That seems rather reasonable to me. Let's look at two choices at this point: Move it to 14 percent or leave it where it is. Who wants to leave it where it is?

MR. ALTMANN. Four, Mr. Chairman.

CHAIRMAN VOLCKER. Who wants to move it to 14?

MR. ALTMANN. Five.

CHAIRMAN VOLCKER. And I didn't vote. I assume we have one or two [who didn't express a preference].

MR. ALTMANN. Only one. There are only 11 members.

SEVERAL. I don't think it's critical.

CHAIRMAN VOLCKER. Well, do we have a consensus at 13 percent?



MR. RICE. It isn't how high we raise it; it's whether we need to move it at all.

MR. PARTEE. I would prefer 13 over--

CHAIRMAN VOLCKER. Let me just try 13 and see whether that--

MR. TIMLEN. As opposed to 11-1/2, I'll vote for 13.

MR. PARTEE. You want it as high as you can get it.

MR. TIMLEN. [Unintelligible] because it's not high enough.

MR. ALTMANN. I think that's five.

CHAIRMAN VOLCKER. Well, I just don't know the strength of conviction of the various sides here. But if we make a Solomonian judgment--

MR. PARTEE. How many people will vote for anything?

MR. SCHULTZ. The [decision] certainly should not rise or fall on this issue.

CHAIRMAN VOLCKER. Let me just try the 4-1/2 percent for six months and the formal specification of 13 to 20 percent, which has the merit of being a compromise if nothing else. Is that generally acceptable? Okay, let's vote.

MR. ALTMANN. One question: We have 4-1/2 percent or somewhat less for M-1A and 5 percent or somewhat less for M-1B. Do I assume the 7-3/4 percent for M2 stands?

CHAIRMAN VOLCKER. Oh gosh, poor M2 got lost in the shuffle.

MR. ALTMANN. Last time the directive said "about." We could say "about" and I suppose that would be good enough.

MR. PARTEE. I'd rather let it stand.

CHAIRMAN VOLCKER. We'll let that stand. Shall we have the "about"?

MR. PARTEE. It's running a little high.

MR. ALTMANN. About 7-3/4 percent and then 13 to 20 percent on the federal funds rate range.

CHAIRMAN VOLCKER. Okay?

MR. ALTMANN.

Chairman Volcker	Yes
President Guffey	Yes
President Morris	Yes
Governor Partee	Yes
Governor Rice	Yes
President Roos	Yes
Governor Schultz	Yes

Governor Teeters	Yes
First Vice President Timlen	Yes
Governor Wallich	No
President Winn	Yes

Ten for, one against.

MR. TIMLEN. Having in mind the special credit restraint program that the Federal Reserve announced last Friday, there may be some advantage in including a sentence in the directive that would make reference to the rate of growth of bank credit falling within a range of 6 to 9 percent. To have that as part of the directive would be supportive of your commentary over the last 3 or 4 days.

CHAIRMAN VOLCKER. Can we say that for the first half of the year? I would agree with the thrust of what you're saying, that something here in the directive would be useful.

MR. PARTEE. We can't have 6 to 9 percent in the first half. It's not possible.

MR. AXILROD. We don't think it's possible in the first half. Given the strength we already have, it would take an enormous reduction.

MR. TIMLEN. Maybe the number is not the precise number that we want.

MS. TEETERS. We'd have to put it in terms of the whole year.

CHAIRMAN VOLCKER. It's already in for the whole year, but it's not--

MR. TIMLEN. It's not very prominent in terms of what people can see.

CHAIRMAN VOLCKER. I wonder whether we shouldn't try to get something in this directive. Maybe we just can't put a number in at this point but we can say "taking account of the need for restraint on bank credit" or some language of that sort.

MR. TIMLEN. Make it qualitative and not quantitative?

MR. MAYO. We could say "taking account of our needs in bank credit, consistent with the 6 to 9 percent [objective] for the year."

MR. SCHULTZ. Or we could say "Close attention will be paid to bank credit" or something like that.

CHAIRMAN VOLCKER. Well, let's see if we're in agreement. We'll try to work on some phrase, which probably has to be qualitative rather than quantitative for the six-month period, and get it in there. And let's get some discussion in the earlier nondirective part [of the policy record] about the importance of bank credit, too.

MR. AXILROD. You could easily look to a marked slowing over the next two months from the recent [rate].

CHAIRMAN VOLCKER. Yes. Maybe that's the way to put it in: "Taking account of the need for a slowing in the rate of growth of bank credit over the next few months, consistent with the objective for the year."

There are a couple of other items that we should be taking up, if I can find [my agenda]. We have the [proposal] regarding the authorization for domestic open market operations. To the best of my knowledge there have been no questions raised about that. If we can get that approved, it would be helpful.

MR. SCHULTZ. So moved.

CHAIRMAN VOLCKER. Without objection, that is approved. The same for the authorization for foreign currency operations. No questions have been raised.

SPEAKER(?). So moved.

MR. ALTMANN. There is a housekeeping amendment in one paragraph.

CHAIRMAN VOLCKER. What is that, Mr. Altmann?

MR. ALTMANN. There is just one housekeeping amendment. In line with the changes in organization that the Committee approved last August, in effect changing the titles of the Managers, in paragraph 6 of the foreign currency authorization where the word "Manager" appears, we would simply change it to "Manager for Foreign Operations."

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection. Now we go to the authority for lending securities. This is more substantive. We've reviewed this at intervals, quite a few intervals. I take it the proposal is to continue it unchanged. If nobody has any problems with that, I would hope we could approve that with equal expedition.

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection, that's approved. The warehousing of foreign currencies, I think, falls in the same category. If you want to have a discussion of that, I would propose a very short-term approval of [the current procedures] and consider it at a meeting when we have time to discuss it. But if it doesn't need any discussion, we'll approve it for another year.

SPEAKER(?). So moved.

SPEAKER(?). Second.

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CHAIRMAN VOLCKER. Without objection, it's approved for another year. The only remaining item we have is the date of the next meeting, Tuesday, April 22.

SPEAKER(?). So moved.

CHAIRMAN VOLCKER. Approved without objection. Thank you.

END OF MEETING